The Institute of Chartered Accountants in England and Wales

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Workbook

For exams in 2021

icaew.com

Financial Management

The Institute of Chartered Accountants in England and Wales

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Contents

Questions within the Workbook should be treated as preparation questions, providing you with a firm foundation before you attempt the exam-standard questions. The exam-standard questions are found in the Question Bank.

Welcome to ICAEW

I'd like to personally welcome you to ICAEW.

In a fast-changing and volatile world, the role of the accountancy profession has never been more important.

As an ICAEW Chartered Accountant, you will make decisions that will define the future of global business.

By choosing our world-leading chartered accountancy qualification, the ACA, you will acquire exceptional knowledge and skills – with technology and ethics at the heart of your learning. A focus on capabilities such as judgement and scepticism will enable you to make the right decisions in diverse and often complex environments.

You will be equipped to flourish and to lead in areas that are transforming the business landscape. This includes embracing technological change and harnessing digital disruption, to help our profession deliver greater value. It also includes putting climate change and sustainability at the heart of business strategy. We will equip you to be adaptable and agile in your work and all within a set of values fundamental to trust and transparency, which will set you apart from others.

Joining over 184,500 ICAEW Chartered Accountants and students worldwide, you are now part of a global community. This unique network of talented and diverse professionals work in the public interest to build economies that are sustainable, accountable and fair.

You are also joining a community of 1.8m chartered accountants and students as part of Chartered Accountants Worldwide – a family of leading institutes, of which we are a founder member.

ICAEW will support you through your studies and throughout your career: this is the start of a lifetime relationship, and we will be with you every step of the way to ensure you are ready to face the challenges of the global economy. Visit page v to review the key resources available as you study.

With our training, guidance and support, you will join our members in realising your career ambitions, developing world-leading insights and maintaining a competitive edge.

We will create a world of strong economies, together.

I wish you the best of luck with your studies.

Michael Izza

Chief Executive

ICAEW

Financial Management

If you are studying this exam as part of the ACA qualification go to icaew.com/examresources or if you are studying the ICAEW CFAB qualification go to icaew.com/cfabstudents.

Module aim

Financial Management enables students to recommend relevant options for financing a business, recognise and manage financial risks and make appropriate investment decisions.

On completion of this module, students will be able to:

- identify capital requirements of businesses, assess financing options and recommend relevant methods of financing;
- identify the financial risks facing a business and the principal methods of managing those risks; and
- apply appropriate investment appraisal techniques taking into account other factors affecting investment decisions.

Method of assessment

The Financial Management module exam is 2.5 hours long. The exam consists of three questions. Managing financial risk will be assessed as a discrete topic. The other two questions will assess financing options and investment decisions and valuation either as discrete or integrated topics.

Specification grid

This grid shows the relative weightings of subjects within this module and should guide the relative study time spent on each. Over time the marks available in the assessment will equate to the weightings below, while slight variations may occur in individual assessments to enable suitably rigorous questions to be set.

	Weighting (%)
1 Financing options	35
2 Managing financial risk	30
3 Investment decisions and valuation	35

Permitted texts

At the Professional and Advanced Levels there are specific texts that you are permitted to use during your exam. All information for these texts is available on icaew.com/permittedtexts.

Professional level exams	Permitted text
Audit and Assurance	✔
Financial Accounting and Reporting	✔
Tax Compliance	✔
Business Strategy and Technology	x
Financial Management	x
Business Planning	No restrictions

Advanced Level exams	
Corporate Reporting	No restrictions
Strategic Business Management	No restrictions
Case Study	No restrictions

The exams which have no restrictions include the following:

- Business Planning: Banking;
- Business Planning: Insurance;
- Business Planning: Taxation;
- Corporate Reporting;
- Strategic Business Management; and
- Case Study.

This information, as well as what to expect and what is and is not permitted in each exam is available in the Instructions to Candidates. You will be sent the instructions with your exam admission details. They can also be viewed on our website at icaew.com/exams.

Key resources

Whether you're studying the ACA qualification with an employer, at university, independently (self-studying), or as part of an apprenticeship, we provide a wide range of resources and services to help you in your studies.

Take a look at the online exam resources available to you on icaew.com/examresources and discover more resources and services at icaew.com/studentbenefits.

Syllabus, skills development and technical knowledge grids

This syllabus presents the learning outcomes for each exam and should be read in conjunction with the relevant technical knowledge grids and, where applicable, the skills development grids.

Exam support

A variety of exam resources and support have been developed on each exam to help you on your journey to exam success. This includes exam guidance, sample exams, hints and tips from examiners and tutors, on-demand webinars and articles.

Past exams and mark plans

Use past exams to practise answering questions. The mark plans will help you check your answers. The past exams and mark plans are included in your Question Bank and have been updated to reflect the 2021 legislation and syllabus.

Errata sheets

These documents will correct any omissions within the learning materials once they have been published. You should refer to them when studying.

Exam software

It is vital that you are familiar with the exam software before you take your exam. Access a variety of resources, including the practice software and sample exams at icaew.com/studentresources.

Student support team

Our student support team is here to help and advise you, so do not hesitate to get in touch. Email studentsupport@icaew.com or call +44 (0)1908 248 250. If you are browsing our website, look out for the live help boxes. You will be able to speak directly to an adviser. Mia, our ChatBot, is also on hand to answer your queries.

Online student community

The online student community is the place where you can post your questions and share your study tips. Join the conversation at icaew.com/studentcommunity.

ICAEW Quarterly and Student Insights

As an ACA student, you will also receive a copy of our member magazine, *Quarterly*. Read more at icaew.com/insights.

You'll also be able to access our practical and topical student content on our dedicated online student hub, Student Insights.

You'll find new-look features, interviews and guides giving you fresh insights, innovative ideas and an inside look at the lives and careers of our ICAEW students and members. No matter what stage you're at in your journey with us, you'll find content to suit you.

Tuition

The ICAEW Partner in Learning scheme recognises tuition providers who comply with our core principles of quality course delivery. If you are not receiving structured tuition and are interested in doing so, take a look at ICAEW recognised Partner in Learning tuition providers in your area at icaew.com/dashboard.

CABA

It can be tough juggling your studies with work, planning for the future and finding time to unwind. CABA are an independent charity that supports the well-being of the chartered accountant community. So, if you need support at home or at work, CABA is there for you. They provide information, advice and lifelong support to ACA students across the world face-to-face, over the phone and online. All their services are completely free and strictly confidential. Find out more at caba.org.uk.

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ICAEW Business and Finance Professional (BFP) is an internationally recognised designation and professional status. It demonstrates your business knowledge, your commitment to professionalism and that you meet the standards of a membership organisation. Once you have completed the ICAEW CFAB qualification or the ACA Certificate Level, you are eligible to apply towards gaining BFP status. Start your application at icaew.com/becomeabfp.

Skills within the ACA

Professional skills are essential to accountancy and your development of them is embedded throughout the ACA qualification.

The level of competency required in each of the professional skills areas to pass each module exam increases as ACA trainees progress upwards through each Level of the ACA qualification. The skills progression embedded throughout the ACA qualification ensures ACA trainees develop the knowledge and professional skills necessary to successfully operate in the modern workplace and which are expected by today's forward-thinking employers.

The following professional skills areas are present throughout the ACA qualification.

Skill area	Overall objective
Assimilating and using information	Understand a business or accounting situation, prioritise by determining key drivers, issues and requirements and identify any relevant information.
Structuring problems and solutions	Structure information from various sources into suitable formats for analysis and provide creative and pragmatic solutions in a business environment.
Applying judgement	Apply professional scepticism and critical thinking to identify faults, gaps, inconsistencies and interactions from a range of relevant information sources and relate issues to a business environment.
Concluding, recommending and communicating	Apply technical knowledge, skills and experience to support reasoning and conclusion and formulate opinions, advice, plans, solutions, options and reservations based on valid evidence and communicate clearly in a manner suitable for the recipient.

The following provides further detail on the professional skills that you will develop in this particular module. To see the full skills development grids, please go to icaew.com/examresources.

Assimilating and using information

Understand the situation and the requirements

- Demonstrate understanding of the business context
- Recognise new and complex ideas within a scenario
- Identify the needs of customers and clients
- Explain different stakeholder perspectives and interests
- Identify risks within a scenario
- Identify elements of uncertainty within a scenario
- Identify ethical issues including public interest and sustainability issues within a scenario

Identify and use relevant information

- Interpret information provided in various formats
- Evaluate the relevance of information provided
- Use multiple information sources
- Filter information provided to identify critical facts

Identify and prioritise key issues and stay on task

- Identify business and financial issues from a scenario
- Prioritise key issues
- Work effectively within time constraints
- Operate to a brief in a given scenario

How skills are assessed: students may be required to:

- absorb and understand both structured and unstructured material; and

- give recommendations based on their understanding and interpretation of the information provided, supported by explanation of the reasoning behind and implications of their recommendations.

Structuring problems and solutions

Structure data

- Structure information from various sources into suitable formats for analysis
- Identify any information gaps
- Frame questions to clarify information
- Use a range of data types and sources to inform analysis and decision making
- Structure and analyse financial and non-financial data to enhance understanding of business issues and their underlying causes
- Present analysis in accordance with instructions and criteria

Develop solutions

- Identify and apply relevant technical knowledge and skills to analyse a specific problem
- Use structured information to identify evidence-based solutions
- Identify creative and pragmatic solutions in a business environment
- Identify opportunities to add value
- Identify and anticipate problems that may result from a decision
- Identify a range of possible solutions based on analysis
- Identify ethical dimensions of possible solutions
- Select appropriate courses of action using an ethical framework
- Identify the solution which is the best fit with acceptance criteria and objectives
- Define objectives and acceptance criteria for solutions

How skills are assessed: students may be required to:

- assimilate significant amounts of information, to analyse it (including quantitative analysis) in a way that demonstrates relevant technical knowledge and to draw and support appropriate conclusions.

Applying judgement

Apply professional scepticism and critical thinking

- Recognise bias and varying quality in data and evidence
- Identify assumptions or faults in arguments
- Identify gaps in evidence
- Identify inconsistencies and contradictory information
- Assess interaction of information from different sources
- Exercise ethical judgement

Relate issues to the environment

- Appreciate when more expert help is required
- Identify related issues in scenarios
- Assess different stakeholder perspectives when evaluating options
- Retain an overview of the business issue or scenario
- Appraise corporate responsibility and sustainability issues
- Appraise the effects of alternative future scenarios
- Appraise ethical, public interest and regulatory issues

How skills are assessed: students may be required to:

- make sense of relatively large volumes of data, making judgments on the relevance of data for use in subsequent calculations and discussions;
- reflect on their calculations and the methodology employed and to identify and discuss the implications of calculations; and

- make and justify judgements based on earlier calculations.

Concluding, recommending and communicating

Conclusions

- Apply technical knowledge to support reasoning and conclusions
- Apply professional experience and evidence to support reasoning
- Use valid and different technical skills to formulate opinions, advice, plans, solutions, options and reservations

Recommendations

- Present recommendations in accordance with instructions and defined criteria
- Make recommendations in situations where risks and uncertainty exist
- Formulate opinions, advice, recommendations, plans, solutions, options and reservations based on valid evidence
- Make evidence-based recommendations which can be justified by reference to supporting data and other information
- Develop recommendations which combine different technical skills in a practical situation

Communication

- Present a basic or routine memorandum or briefing note in writing in a clear and concise style
- Present analysis and recommendations in accordance with instructions
- Communicate clearly to a specialist or non-specialist audience in a manner suitable for the recipient
- Prepare the advice, report, or notes required in a clear and concise style

How skills are assessed: students may be required to:

- recommend suitable courses of action in a given situation (financing decisions, dividend decisions, investment appraisal decisions); and
- incorporate advice within a 'business report' format, addressing both the strengths and weaknesses of any recommendations and/or reasons for the rejection of alternatives.

To help you develop your ability to demonstrate competency in each professional skills area, each chapter of this Workbook includes up to four Professional Skills Guidance points.

Each Professional Skills Guidance point focuses on one of the four ACA Professional Skills areas and explains how to demonstrate a particular aspect of that professional skill relevant to the topic being studied. You are advised to refer back to the Professional Skills Guidance points while revisiting specific topics and during question practice.

Chapter 1

Value added tax – further aspects

Introduction

Learning outcomes

- Identify the records which companies and individuals must retain for tax purposes
- Determine, in straightforward cases, due dates for businesses' VAT returns and payments
- Calculate the monthly, quarterly or annual VAT payable or repayable by a business
- State the alternative schemes for payment of VAT by businesses and calculate the VAT payable or repayable for a business using these

Specific syllabus references for this chapter are: 2a, 2d, 6e, 6f.

Syllabus links

The topics in this chapter and the previous chapter form the basis of your understanding of value added tax.

Many of the administrative aspects of VAT are not tested in the Tax Compliance exam, so you may expect to find them in the Principles of Taxation exam. At Professional Level you will deal with further aspects of VAT such as groups and overseas transactions.

Examination context

In the examination, in the objective test questions, students may be required to:

- calculate the VAT payable or reclaimable for a period
- identify the schemes available to small businesses and apply the rules of the schemes

For extra question practice on these topics go to the section of the Question Bank covering this chapter.

Chapter study guidance

Use this schedule and your study timetable to plan the dates on which you will complete your study of this chapter.

Topic	Practical significance	Study approach	Exam approach	Interactive questions
1	**Accounting for VAT** Many businesses complete their own VAT returns and just ask their accountant to deal with problems. Although a business is merely collecting VAT on behalf of the government, many still resent having to pay over the cash when it falls due. Indeed, for many smaller businesses, collecting and paying VAT can create severe cashflow difficulties.	**Approach** Read through section 1, working carefully through the worked examples and interactive question. This section will help to bring together what you learned in the previous chapter. **Stop and think** Did you realise that VAT administration can be a significant burden for businesses? A	You may be required to calculate the VAT payable or reclaimable for a period in an objective test question. This will involve netting off the correct output and input VAT figures for the return period.	**IQ1: VAT due** This example gives you a chance to analyse the information given, determine which figures are relevant, and calculate the output VAT payable and input VAT recoverable. It combines knowledge from Chapters 11

Topic	Practical significance	Study approach	Exam approach	Interactive questions
		competent accountant can provide invaluable support by advising on when these administrative burdens can be alleviated, or by helping a business with its VAT administration.		and 12.
2	Small business schemes Successive governments have introduced schemes designed to simplify VAT administration to make it less of a burden for business. An accountant can help a business by advising on the special schemes for which it may be eligible. Some of these schemes just reduce paperwork by reducing the frequency of returns, but others can actually reduce the amount of VAT which a business pays over to HMRC. Not all businesses will benefit from using the schemes, however, so it is important to understand when they are relevant.	**Approach** Study each of the small business schemes in turn, focusing on the numerical examples for annual accounting and the flat rate scheme. **Stop and think** As you look at each scheme, think about the types of businesses who would benefit from using them. What are the benefits? Are there any drawbacks?	An objective test question may require you to identify the schemes available to small businesses and apply the rules of the schemes. There is a lot of detail here and it is important not to get the schemes confused with each other.	
3	VAT records and accounts HMRC are entitled to raise enquiries about any of a trader's tax affairs, and the trader must be able to substantiate the figures contained in their VAT returns. Specific records must be retained and certain details are required to be contained on VAT invoices. This is in order	**Approach** Read quickly through the information in this topic. Try to remember as many of the types of records and contents of a VAT invoice as you can. **Stop and think** What are the advantages of	You may be required to identify the types and format of records which companies and individuals must retain. This would be examined as a narrative objective test question.	

Topic	Practical significance	Study approach	Exam approach	Interactive questions
	to prove the accuracy of the VAT liabilities. The move towards Making Tax Digital has been a significant recent advancement in the way records are retained, and information is transferred to HMRC. This was first introduced for VAT, with other taxes to be brought into the Making Tax Digital system later.	keeping records digitally and communicating electronically with HMRC?		

Once you have worked through this guidance you are ready to attempt the further question practice included at the end of this chapter.

1 Accounting for VAT

Section overview

- VAT is normally accounted for in quarterly VAT periods.
- The VAT return and VAT payable are due one month and seven days after the end of the VAT period.
- Substantial traders must make payments on account of VAT for each quarter

2.1 VAT periods

The period covered by a VAT return is called a **VAT period** or tax period. Normally the VAT period is a quarter (a three-month period). The end date of the first VAT period is specified in the certificate of registration and dictates what the quarter dates will be going forward.

HMRC will allow taxable persons to have a one-month VAT period where input tax regularly exceeds output tax, ie, where the taxable person is in a net VAT repayment position.

Small businesses may submit a single annual VAT return (see later in this chapter).

2.2 VAT return

All VAT-registered businesses must submit their VAT returns (Form VAT100) online and pay any VAT due in respect of those returns electronically.

The VAT return must show the amount of VAT payable or recoverable and be submitted to HMRC not later than seven calendar days after the last day of the month following the end of the return period. This is also usually the due date for any VAT payment. If payment is made by direct debit, it is automatically collected a further three working days after the due date.

Businesses that file annual returns or make payments on account have special due dates for their returns and payments (see later in this chapter).

Worked example: VAT due

Fallow Ltd is a manufacturing company. For the quarter to 30 September 2020, the following information is given (all figures excluding VAT):

	£	£
Sales (standard rated)		134,285
Sales (zero rated)		12,500
		146,785
Purchases	37,750	
Wages	23,000	
Bad debt written off	1,500	
UK customer entertaining	750	
Staff entertaining	14,464	(77,464)
Profit		69,321

All purchases and entertaining expenses are standard rated. The bad debt, in respect of a standard rated supply, was written off in August 2020. The payment for the original sale was due on 31 January 2020.

Requirement

What is the VAT payable for the quarter and when is it due for payment?

Solution

Output tax

	£	£
Standard-rated supplies (£134,285 × 20%)		26,857
Input tax		
Purchases	37,750	
Bad debt	1,500	
Staff entertaining	14,464	
	53,714 × 20%	(10,743)
VAT payable (due electronically by 7.11.20)		16,114

Bad debt relief is available because the debt is more than six months old from the due date of payment.

Wages are outside the scope of VAT.

Input tax on UK customer entertaining is irrecoverable.

Professional skills focus: Structuring problems and solutions

When calculating a VAT liability, you must net off the output VAT on supplies made and the recoverable input VAT. The pro-forma in the above example may be useful. Look at each supply made, decide whether VAT applies to it, and at what rate. Remember to pay attention to whether the question gives you net or gross figures. Then review (or calculate) the input VAT suffered and determine whether it is recoverable - only deduct it if you are allowed to!

Worked example: Tax point and accounting for VAT

Jason has the following standard-rated sales during the quarter ended 30 June 2020:

Order 1

Goods dispatched on 2 March 2020. Invoice issued on 25 March 2020 for £1,200 plus VAT. Payment was received on 12 June 2020.

Order 2

Goods dispatched on 28 March 2020. Invoice issued on 10 April 2020 for £680 plus VAT. Payment was received on 7 July 2020.

Requirement

What is the VAT payable for the quarter ended 30 June 2020 and when is it due for payment?

Solution

Tax point is the basic tax point for order 1, and the invoice date for order 2 (as it is within 14 days of basic tax point and before payment received).

The quarter ended 30 June 2020 only includes the VAT charged on order 2 as the quarter runs from 1 April 2020 to 30 June 2020. The VAT payable electronically on 7 August 2020 is £136.

Order 2

Tax point is 10 April 2020

VAT @ 20% of £680	£136

Interactive question 1: VAT due

Dev is registered for VAT. His VAT period ends on 31 March 2021.

During this period Dev made zero-rated supplies of £46,000 and standard-rated supplies of £59,070. These are VAT-exclusive figures.

Dev made standard-rated purchases of £59,489 (inclusive of VAT) during the period. Purchases included a new car for 90% business use by Dev, which he bought for £15,000 plus VAT.

Requirement

Using the standard format below, compute the VAT payable/repayable for the quarter.

	£
Output tax	
Input tax	
VAT payable/repayable	

See **Answer** at the end of this chapter.

2.3 Payments on account

Substantial traders are taxable persons with an annual VAT liability in excess of £2.3 million. A substantial trader must make **payments on account** of VAT for each quarter. This must be done electronically.

Payments are due at the end of the second and third months of the quarter. The amount of each payment is 1/24 of the total VAT liability for the previous year.

The balancing payment for the quarter is due with the VAT return at the end of the month following the end of the quarter.

3 Small business schemes

Section overview

- The annual accounting scheme allows a business to submit one VAT return per year.
- The cash accounting scheme allows a business to account for VAT on a cash basis.
- Under the flat rate scheme, output VAT is based on a fixed percentage of VAT inclusive turnover but there is no recovery of input VAT.

4.1 Annual accounting scheme

Definition

Annual accounting scheme: A scheme available to small businesses which allows them to make payments on account of VAT during the year based on the previous year's VAT liability. A single VAT return for the year is then filed within two months of the year end together with any balancing payment of VAT due

The annual accounting scheme is helpful to small businesses as it cuts down on the administrative burden of VAT by allowing the business to submit one VAT return every 12 months. The VAT return is due within two months of the end of the year.

A business may join the annual accounting scheme if the value of taxable supplies (excluding VAT and supplies of capital items) in the following year is not expected to exceed £1.35 million.

Businesses already in the scheme may continue to use it until the value of taxable supplies in the previous 12 months exceeds £1.6 million.

The annual accounting scheme requires the trader to make payments on account either as:

- Nine interim payments at monthly intervals throughout the year, or
- Three quarterly interim payments throughout the year

The trader then must either pay any outstanding VAT or receive a refund if they have overpaid VAT, after the end of the year (see below). In total the trader will therefore either make 10 payments or 4.

If the trader has opted to make nine equal monthly payments, each payment must be electronic and will be 10% of the total VAT liability for the previous year, or 10% of the estimated VAT liability for the current year if the trader has been registered for VAT for less than 12 months. The first payment is due at the end of the fourth month, with no seven day extension, and then every month after that.

If the trader has opted to make three quarterly instalments, each payment must be electronic and will be 25% of the previous year's VAT liability, or 25% of the estimated VAT liability for the current year if the trader has been registered for VAT for less than 12 months. The payments are due by the end of months 4, 7 and 10 of the annual accounting year.

In the examination, you will always be given the VAT liability for the previous year or HMRC's estimate of the VAT liability for the current year where a trader has been registered for VAT for less than 12 months. You will also be told whether the trader has opted to make monthly or quarterly payments.

Any balancing payment is due when the VAT return is made, ie, by the last day of the second month after the end of the year. If paid by direct debit, HMRC will collect it three working days after the due date for the return.

Professional skills focus: Assimilating and using information

Noting a business's VAT year end, and whether it has opted for quarterly or monthly payments, will be vital facts in determining the dates of its annual accounting scheme payments on account.

Worked example: Annual accounting scheme

W Ltd joined the annual accounting scheme two years ago and elected to make monthly payments. W Ltd's total VAT liability for the year to 31 May 2020 was £12,800.

The actual VAT liability for the year to 31 May 2021 was £16,250.

Requirement

For the year to 31 May 2021, what are the payments on account and balancing payment and when are they due?

Solution

Payments on account

1/10 × £12,800	£1,280

Due by 30 September 2020 and then at the end of each month until 31 May 2021

Balancing payment

(£16,250 – [£1,280 × 9])	£4,730

Due by 31 July 2021

The main advantages of the annual accounting scheme are therefore:

- The reduction in the number of VAT returns required
- Two months to complete the annual return and make the balancing payment

The annual accounting scheme can be used in conjunction with either the cash accounting scheme or the flat rate scheme

4.2 Cash accounting scheme

Definition

Cash accounting scheme: The cash accounting scheme allows businesses to account for VAT on the basis of cash paid and received, rather than on invoices received and issued.

Small businesses may join the cash accounting scheme if the value of taxable supplies (excluding VAT and supplies of capital items) in the following year is not expected to exceed £1.35 million. The business must have submitted all its VAT returns to date and paid all outstanding VAT. It must not have been convicted of a VAT offence or penalty in the previous 12 months.

Businesses already in the cash accounting scheme may continue to use it until the value of taxable supplies in the previous 12 months exceeds £1.6 million.

The main advantages of the scheme are:

- output VAT does not have to be accounted for until payment is received
- automatic bad debt relief since no output VAT is payable if payment is not received

However, note that input VAT cannot be recovered until the business has actually paid the supplier for purchases.

4.3 Flat rate scheme

Definition

Flat rate scheme for VAT: The flat rate scheme allows businesses to calculate net VAT due to HMRC by applying a flat rate percentage to their VAT-inclusive turnover rather than accounting for VAT on individual sales and purchases.

The flat rate percentage is set by the type of business carried on. It ranges from 4% (food retailers) to 14.5% (for example, building or construction services where labour only is supplied and accountancy services). There is a fixed percentage of 16.5% for limited cost traders. For examination purposes, the question will state which percentage to apply.

There is a 1% reduction during the first year of VAT registration. For examination purposes, the percentage given in the question will include this 1% reduction where appropriate. The business will issue tax invoices using the normal rules and applying the appropriate rate of VAT, eg, standard rate, zero rate. It does not have to keep records of the input VAT on individual purchases.

The VAT payable to HMRC at the end of the VAT period is the flat rate percentage multiplied by the VAT-inclusive turnover for the period. There is no deduction for input VAT. The VAT-inclusive turnover includes taxable supplies, exempt supplies and supplies of capital assets.

Worked example: Flat rate scheme

Leon uses the flat rate scheme for his business. He has been registered for VAT for five years, making standard-rated supplies. The flat rate percentage is 9%.

In the quarter to 30 June 2020, Leon had the following transactions:

	£
Sales	25,200
Purchases	7,100
Expenses	2,500

All figures exclude VAT

Requirement

What is the VAT due for the quarter?

Solution

VAT inclusive turnover

	£30,240
VAT due £30,240 × 9%	£2,722

A business may join the flat rate scheme if the value of its annual taxable supplies (excluding VAT) does not exceed £150,000.

The main advantages of the scheme are:

- Reduction in the burden of administration of preparing the VAT return as no records of input VAT need be kept
- Frequently less VAT payable to HMRC than under the normal rules

If a business has total annual income (inclusive of VAT) in excess of £230,000 it must leave the flat rate scheme. This condition includes exempt income.

While your exam questions will not ask you to recommend whether a trader should use any of the special schemes, you are expected to appreciate the benefits and potential drawbacks of each one. Most traders want to spend time running their business and not on the administration of their tax affairs!

5 VAT records and accounts

Section overview

- VAT records must be kept to support output VAT charged and the claim for recoverable input VAT.
- Records must be kept for at least six years.
- A VAT invoice must contain details such as the tax point, VAT registration number and details of the supply.

- Making Tax Digital for Business (MTDfB) requires business with annual taxable turnover above £85,000 to keep their records digitally and provide information to HMRC through MTDfB software.

6.1 Records

HMRC requires a taxable person to keep 'adequate' records and accounts of all transactions to support both output VAT charged and the claim for recoverable input VAT.

The main records to be kept should include:

- Sales invoices
- Order and delivery notes
- Purchase invoices, copy sales invoices and credit notes
- Purchase and sales day books
- Records of daily takings (eg, till rolls)
- Cash book
- Bank statements and paying-in slips
- Annual accounts (profit and loss account and balance sheet)

6.2 VAT invoices

The VAT invoice is the key record to support a claim to recover input VAT and must therefore be issued when a taxable person makes a taxable supply to another taxable person.

A full VAT invoice must show the word 'invoice' and must contain a number of details:

- A unique identification number
- The business name, address and contact information
- The name and address of the customer
- A clear description of the goods or service
- The date of the invoice and the tax point if different
- The price, quantity and VAT rate for each item
- Any discount offered
- The amount charged excluding VAT
- The total VAT charged

In general, a trader must issue a full VAT invoice for every transaction. This rule is relaxed in some circumstances, such as sales for smaller amounts.

Definitions

Simplified VAT invoice: A 'less detailed', or simplified, invoice can be issued for supplies under £250.

Modified VAT invoice: A modified invoice can be issued for retail supplies over £250.

It is not compulsory to issue VAT invoices to non-VAT registered customers unless requested.

6.3 Making Tax Digital for Business

From 1 April 2019, the Making Tax Digital for Business (MTDfB) requirements apply to businesses which have annual taxable turnover above £85,000 (the VAT registration threshold). Initially, the requirements apply for VAT purposes only, although businesses, including those beneath the registration threshold, may use MTDfB on a voluntary basis for both VAT and income tax.

Businesses using MTDfB must:

- keep their records digitally for up to six years; and
- provide their VAT return information to HMRC through MTDfB compatible software which pulls the data directly from the business's digital records.

Summary

!! Error resolving referred content !!

Further question practice

1 Knowledge diagnostic

Before you move on to question practice, complete the following knowledge diagnostic and check you are able to confirm you possess the following essential learning from this chapter. If not, you are advised to revisit the relevant learning from the topic indicated.

Confirm your learning	
1.	Do you know how to compute VAT payable for a period? (Topic 1)
2.	Do you know when a VAT return needs to be filed and the associated liability paid? (Topic 1)
3.	Can you determine the filing date and payment dates under the annual accounting scheme? (Topic 2)
4.	Do you understand how a trader using the flat rate scheme calculates their VAT liability? (Topic 2)
5.	Do you know what records need to be kept for VAT purposes, and for how long they must be retained? (Topic 3)

2 Chapter self-test question practice

Aim to complete all the self-test questions at the end of this chapter. Once completed, attempt all the questions in the VAT- further aspects chapter of the Principles of Tax Question Bank. Refer back to the learning in this chapter for any questions which you did not answer correctly or where the suggested solution has not provided sufficient explanation to answer all your queries. Once you have attempted these questions, you can move on to the next chapter.

Technical reference

1 Legislation

References relate to Statutory Instrument 1995/2518 (*SI 1995/2518*) unless otherwise stated

- VAT returns – **para. 25**
- Payment of VAT – **para. 40**
- Substantial traders – payments on account – **SI 1993/2001**
- Annual accounting scheme – **paras. 49-55**
- Cash accounting scheme – **paras. 56-65**
- Flat rate scheme – **paras. 55A-V**
- Records – **para. 31**
- Invoices – **paras. A13-16**

To find out more practical information about VAT, access the relevant section of the gov.uk website through the page https://www.gov.uk/government/organisations/hm-revenue-customs.

Information on Making Tax Digital can also be found on the gov.uk website: https://www.gov.uk/government/collections/making-tax-digital-for-vat

A series of guides is available online at https://www.gov.uk/topic/business-tax/vat which gives information about the range of special schemes and options to simplify VAT for small businesses is available under the heading 'Accounting for VAT'.

There is also a VAT telephone helpline: 0300 200 3700 (+44 2920 501 261 from abroad)

This technical reference section is designed to assist you. It should help you to know where to look for further information on the topics covered in this chapter. You will not be examined on the contents of this section in your examination.

Self-test questions

Answer the following questions.

- Opal Ltd's VAT accounting periods are in line with its accounting year which ends on 30 September. Opal Ltd is not in the annual accounting scheme.

  By what date must Opal Ltd submit its final VAT return for its accounting year?

  A 30 October

  B 31 October

  C 7 November

  D 10 November

. Tertia is registered for VAT. She joins the annual accounting scheme with effect from 1 June 2020 and is required to make payments on account of her VAT liability. She has opted to make nine interim payments.

Tertia's total VAT liability for the year to 31 May 2020 was £90,000.

The actual VAT liability for the year to 31 May 2021 is £108,000.

For the year to 31 May 2021, what is the amount of the payments on account that will be required under the annual accounting scheme and the amount of the balancing payment?

Options	Payment on accounts	Balancing payment
Option 1	9 × £10,000	£18,00
Option 2	9 × £9,000	£27,000
Option 3	9 × £12,000	£0
Option 4	9 × £10,800	£10,800

A Option 1

B Option 2

C Option 3

D Option 4

.

Which of the following statements about the cash accounting scheme is **not** true?

A VAT is accounted for on the basis of amounts received for supplies and amounts paid for purchases

B The scheme gives automatic bad debt relief.

C The scheme allows deferral of payment for VAT where an extended time for payment is given to customers.

D The scheme is compulsory for taxable persons who will have taxable supplies not exceeding £1.35 million in the following 12 months.

. Linda is registered for VAT and has opted to account for VAT under the flat rate scheme. The VAT rate applicable to her business is 5%.

Which **two** of the following statements are true?

A Linda must calculate net VAT due by applying 5% to the value of her turnover (excluding VAT).

B Linda does not have to keep records of her input VAT.

C Linda must calculate net VAT due by applying 5% to her VAT inclusive turnover.

D Linda will issue tax invoices to her customers showing the value of the supply plus VAT at 5%.

Now go back to the Introduction and ensure that you have achieved the Learning outcomes listed for this chapter.

Answers to Interactive questions

Answer to Interactive question 1

	£
Output tax	
Standard rated supplies £59,070 × 20%	11,814
Input tax	
The VAT on the car will not be recoverable	
Purchases (59,489 – (15,000 × 120%)) = 41,489 × 1/6	(6,915)
VAT payable/repayable	4,899

Answers to Self-test questions

1 Correct answer(s):

C 7 November

Businesses must file VAT returns (and pay their VAT liability) electronically. The deadline for both filing and payment is seven days after the end of the month following the return period. Opal Ltd must file its VAT return by 7 November.

2 Correct answer(s):

B Option 2

Payments on account 9 × £9,000 and balancing payment of £27,000.

Payments on account are nine equal monthly payments which are 1/10 of the total VAT liability for the previous year.

3 Correct answer(s):

D The scheme is compulsory for taxable persons who will have taxable supplies not exceeding £1.35 million in the following 12 months.

The cash accounting scheme is not compulsory.

All the other statements are true. B and C are advantages of the cash accounting scheme that you should recognise

4 Correct answer(s):

B Linda does not have to keep records of her input VAT.

C Linda must calculate net VAT due by applying 5% to her VAT inclusive turnover.

Note that D is not true. Linda will issue tax invoices using the normal rules, eg, standard rated, zero rated.

Chapter 2

Ethical considerations

Introduction

Learning outcomes

- Recognise and explain the relevance, importance and consequences of ethical and legal issues
- Recommend and justify appropriate actions where ethical issues arise in a given scenario
- Design and evaluate appropriate ethical safeguards
- Recognise and advise when, how and to whom an issue should be notified
- Recognise the ethical implications of providing audit and assurance services to a Public Interest Entity

Syllabus learning outcomes LO 5(a)–(e)

Syllabus links

Audit and Assurance

LO 1 Identification of threats to objectivity and appropriate responses

Financial Accounting and Reporting

LO 1(i) Identify and explain the ethical and professional issues for a professional accountant undertaking work in financial accounting and reporting and identify appropriate action

Financial Management

LO 1(c) Evaluate the ethical implications of an entity's financial strategy (including those for the organisation, individuals and other stakeholders) and suggest appropriate courses of action to resolve any ethical dilemmas that may arise

Examination context

The accountant may face ethical issues whether in public practice or in business. The insurance industry can provide a number of specific ethical challenges.

Exam questions may require the candidate to determine and justify an appropriate ethical course of action in a given scenario.

Chapter study guidance

Use this schedule and your study timetable to plan the dates on which you will complete your study of this chapter.

Topic	Practical significance	Study approach	Exam approach	Self - test Questions
1	**Ethical and legal issues that may arise in the insurance context** Ethics covers moral principles and norms against which human actions may be judged. The study of ethics can lead to an identification of good or bad conduct and the identification of virtuous behaviour.	Consider the specific features of the insurance sector which make ethical behaviour particularly important.	Typically each examination will contain at least one question focussed on life insurance.	**Q2 – Identifying issues** A simple example to test the identification of ethical issues

	Ethical issues may arise both for accountant in business and in practice			
2	**Using the ICAEW code to resolve ethical dilemmas** Professional bodies such as those for accountants typically produced produce ethical codes governing the conduct of their members in order to promote high ethical standards.	Make sure you can follow a logical process in order to resolve an ethical issue.	If faced with an ethical conflict or dilemma, your answers should aim to clearly demonstrate that you are applying the code's methodology to resolve it.	**Q2 – Ethical behaviour** an opportunity to identify an ethical course of action.
3	**Ethical safeguards** When there is a threat to an ethical duty, actions known as ethical safeguards can be taken to mitigate that threat.	It is important to appreciate what steps can be taken to mitigate threats to ethical duties. I should be noted that a threat may be too severe to be amenable to safeguard..	If you are asked to identify ethical issues and recommend safeguards ensure that you make it clear which safeguard relates to which issue. A tabular approach is often a good approach to take in producing an answer.	
4	**Responsibilities of auditors to report regulatory issues** The auditor has a responsibility to report on matters specified in legislation or by a regulator. The auditor is required to carry out appropriate procedures sufficient to form an opinion on the matters concerned.	Make sure that you understand the grounds for an auditor reporting directly to a regulator under s342. Also consider how lesser matters may be communicated by other means.	Regulatory issues that are deemed insufficiently significant for reporting to regulators under s342, may nonetheless be reported to regulators by other means or reported to TCWG. It is key that your recommendations are proportionate.	
5	**Whistleblowing** Whistleblowing involves confidential disclosure made by an employee or other person related to suspicions of wrongdoing by another person or firm.	Make sure you understand the interaction of PIDA and the accountant's duty of confidentiality.	It should be remembered that whistleblowing exists as a last resort and would very rarely be an appropriate first step. Also remember that it is not an appropriate means to address a personal grievance.	

1 Ethical and legal issues that may arise in the insurance context

Section overview

- A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest.
- A professional accountant's responsibility is not exclusively to satisfy the needs of an individual, client, or employer.

Ethics covers moral principles and norms against which human actions may be judged. The study of ethics considers whether actions of individuals or organisations are **right or wrong**. The study of ethics can lead to an identification of good or bad conduct and the identification of **virtuous behaviour**. However, it must be noted that ethics is not a scientific discipline. Its application requires judgement and all will not come to identical conclusions when faced with an ethical problem.

In the Business Planning: Insurance syllabus, there is a substantial overlap between ethics and regulation. Many situations that would rightly be judged unethical are also unlawful. However, ethics is wider than the law. Just because something is lawful, it does not automatically follow that it is right. Suitably robust ethical decision making involves many matters, such as identifying all the stakeholders that are likely to be affected by a decision. A stakeholder is any person, internal or external to the company, that can reasonably be expected to be affected by a company's decisions.

Business ethics is about managing ethics in an organisational context and involves applying principles and standards that guide behaviour in business conduct.

Business ethics applies to all aspects of business practices, from how organisations develop, produce, and deliver products and services, to interactions with customers, suppliers, employees, and society.

It encompasses human rights; labour and employment practices, such as training, diversity, gender equality, and employee health and wellbeing; and bribery and corruption.

Some organisations also use the term to cover environmental sustainability issues, such as climate change and resource efficiency.

There are a number of ethical dilemmas facing insurers. On one level, a non-mutual insurer exists to make a profit for its investors. If such a company were a health insurer, there is pressure to minimise the cost of health care for policyholders. This clearly is against the best interests of policyholders, who would expect the best healthcare possible within the limits of their policy. Where such ethical dilemmas exist, it is important to understand the legal and constructive obligations on the company by looking at the legitimate expectations of policyholders. This overlaps with the concept of treating customers fairly in accordance with the FCA rules.

Insurers may also wish to obtain the most accurate information possible about the risks they are undertaking. To some extent, this may be seen to undermine the core purpose of insurance, which is the pooling of risk. It is legal and proper for insurers to ask proposers of policies questions that would legitimately affect premium rating (ie, premium pricing), but excessive refining of data may undermine the purpose of taking out insurance. It is, however, proper and normal for insurers to take into account matters outside a policyholder's control if they are relevant to premium rating, such as age of a person proposing health or life insurance.

The ethical duties of insurance extend to policyholders as well as insurance companies themselves. Clearly, it is unethical and illegal to make a false claim. Policyholders may be inclined to take greater risks once they know they have cover than if they have no cover. This is often referred to as moral hazard. Most insurance policy wordings will require policyholders to take the same standard of care as if they did not have insurance, such as taking care to ensure that insured properties are locked. This is difficult to prove and enforce and so largely relies upon the personal ethical standards of policyholders.

Worked example: Sharp practice

One of the key objectives of insurance companies is to maximise shareholder returns. In the general insurance industry profit will be achieved by reducing the number of successful claims that are made by policyholders. To achieve this a company could put in place complex and time-consuming claims procedures and could routinely send claimants an initial claim rejection letter. Such tactics would no doubt successfully reduce the quantity of successful claims. However, leaving specific regulatory issues aside, to what extent could these tactics be considered ethical business conduct?

Solution

Ethics involves notions of doing what is 'right' or virtuous. In the context of business this can be taken to include acting with integrity and fairness and balancing the duties and obligations to different stakeholders. The behaviour of insurance companies described above might be described as sharp practice. It fails to treat customers fairly and appropriately balance the needs of policyholders and shareholders.

There is an inevitable conflict of interest (at least in the short term) between customers and shareholders in many financial services industries where, due to the asymmetry of knowledge, the customer relies on the product provider. This is one of the reasons why a detailed regulatory environment has developed in the UK governing the way in which financial services firms conduct business.

Practice ethics concerns the professional ethics that arise in the context of an accounting firm rendering professional services, encompassing assurance through to advisory, and to clients.

In order to attempt to ensure that members of a profession conduct themselves ethically most professional bodies, such as ICAEW, have an ethical code to which its members must adhere. Breaches of such professional codes of conduct typically lead to sanctions and potentially expulsion from that profession. Such ethical codes exist for professions including doctors, lawyers and accountants.

As you have already encountered in previous studies, the ICAEW Code of Ethics applicable to its members identifies five fundamental ethical principles for the accountant as follows:

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality
- Professional behaviour

The ICAEW Code of Ethics highlights the importance of **professional scepticism** in meeting fundamental principles. It states that 'professional scepticism and the fundamental principles.… are inter-related concepts'. The code also highlights the link between professional scepticism and the independence of mind required for integrity and objectivity. In the exam, pay attention to the source of each exhibit and be alert to the fact that bias is almost unavoidable, even if it's unconscious.

Professional skills focus: Assimilating and using information

Exhibits in exam question may represent information supplied by an insurer's staff or management. It is important that in assimilating and using this information you exercise the degree of professional scepticism that is consistent with the fundamental principles of the code. For example, an investment manager may be over optimistic about the expected future performance of investments that he/she chooses to buy. The objectivity that an independent accountant can bring to these situations is significant.

Interactive question 1: Professional ethics

Provide examples of actions by the auditor of an insurance company that could be considered to breach professional ethics.

See **Answer** at the end of this chapter.

Why ethics is important

Unethical business practices harm organisations and economies. The business failures of Enron, WorldCom, Tyco International, Parmalat, and Arthur Andersen, as well as the more recent failures related to the global financial crisis, highlight the consequences of unethical business practices and amoral management.

Professional skills focus: Applying judgement

Answers to purely ethical issues are inevitably highly judgemental. For example, there is an inherent tension between the interests of an insurer to minimise claims and the insured to maximise them. Regulation essentially codifies ethics to reduce the subjectivity of ethical decisions. Nonetheless, even where regulation exists some degree of judgement is required to apply those regulations to the practical scenarios you will face in exam questions.

2.1 Churning risks

Definition

Churning: Describes the situation where a financial business has persuaded a consumer to surrender or sell an existing investment and take out another – which is either effectively the same or unsuitable for the consumer.

Poor ethical standards clearly have detrimental effects to both consumers and companies posing risks to market confidence and consumer protection:

- It can increase the scope for financial crime.
- It has a negative impact on public awareness and confidence.

Existing investments, including life assurance policies, often provide a dilemma for advisers: whether to advise retention or surrender of those investments. The dilemma is both ethical and legal.

The process of selling or surrendering an investment, and setting up or buying its replacement, commonly known as **'churning'**, generally costs the consumer money.

Another form of churning is where a consumer may be advised to take out an investment with a later maturity date, or one which increases the 'risk profile' of their investments overall.

Ethics demands that the decision must be in the **client's best interest** and **uninfluenced** by consideration of the adviser's fees or other earnings. The rules demand that advisers do not 'churn' a client's investments, including life assurance policies.

If improper advice is given leading a client to cancel a contract and suffer financial loss as a result, the client has a right to claim against the adviser's firm to the extent of that loss.

In recent times there has been considerable media concern over the large number of individuals who have suffered financially by cancelling endowment policies due to falling bonus rates, particularly when linked to the provision of a mortgage.

Mis-selling of pension products, often involving transfers out of employer schemes, has cost the industry **billions** of pounds in compensation.

Demonstrating behaviours like churning and values that are limited to merely complying with the basic rules of any Code of Ethics or Statements of Principle have a direct and measurable negative outcome for the industry, the firm, the adviser and the customer.

Potential outcomes of demonstrating limited compliant behaviours for the assurance industry are:

- **Contraction of the industry**: Ultimately, a lack of trust in the integrity of financial advice will increase the poor reputation of the industry and reduction in the amount of business conducted.
- **Regulatory consequences**: Adherence only to the letter of the regulations will attract far greater scrutiny from the regulator and the potential for fines or other regulatory consequences.

Context example: Context example: John

John is the managing director of an Independent Financial Advisory Firm (IFA) with eight active advisers. The turnover of the company last year was down from the previous year, to approximately £2 million, which came from a combination of new policies and repeat business from existing clients.

The new, and highly recommended, compliance officer of the firm has contacted John as the turnover in the first six months of this financial year has increased to £1.5 million. This means that they are on target for £3 million turnover in this current tax year.

John is delighted with the increase in business as it will allow him to move to larger premises and take on new members of staff providing job security and increased profits for the firm in the foreseeable future.

However, the compliance officer is concerned as the majority of the new business is coming from two advisers who have worked together since they first joined the industry in 2001, and after checking two of their cases has discovered that they are advising their customers to cancel existing life policies in favour of new ones with a different company that coincidentally offer a slightly better commission rate.

John is well aware that the compliance officer has only been part of the firm for three months and seems to be very ambitious, and is also aware that there have not been any major concerns or complaints about the two successful advisers in the past. He has sensed that since the compliance officer's arrival there has been some underlying tension between the compliance officer and the two advisers, and on occasion some loose accusations which have never been proven.

The compliance officer has asked that John suspend the two advisers from selling with effect immediately, until he has checked that all of their new business cases are compliant. This poses a dilemma for John as the two advisers in question are personal friends of his, who all play football together every week, and as the main source of income for the firm this would impact dramatically on the annual profit and the plans to move premises and expand the business.

John asked the compliance officer to wait until he had spoken to the advisers before he took any further action.

Key fundamental principles

Integrity

Consider how John will maintain his integrity – at this time it is just a suspicion on the part of the compliance officer; should he contact the FCA for guidance? Should the past performance of the two advisers provide reassurance to him? Should the compliance officer act on his suspicions immediately?

Objectivity

Does familiarity and loyalty to the two advisers outweigh the knowledge and experience of the compliance officer?

Confidentiality is fundamental to the situation as a whole. But to whom is the duty of confidentiality owed?

Consider whether John should have a 'quiet' word with his team members to ascertain the reason why before they are formally advised of any action to be taken or whether he should defer to the compliance officer's request and trust him to do his job. Would the suspension of two advisers cause some suspicion within the firm and damage to the reputation of the firm?

Professional behaviour

Consider how John should approach this situation and what the consequences would be to the customers, the firm, the advisers and John.

Ethics

Are the two advisers churning? Is John trying to avoid/ignore the issue for the sake of expanding his business? Is there a conflict of interest?

Considerations

Identify relevant facts

Does John look at the cases in question to ascertain if there is any grounds for concern, does he formally interview the advisers, does he also question the compliance manager about the basis of his concerns, does he trust the compliance manager to do his job as he came to the IFA firm with excellent references?

Is there a link to the increased revenue?

John must examine where his duty of confidentiality lies.

Identify affected parties

The customers, the advisers, the compliance officer, John, the firm, the assurance company, the FCA.

Who should be involved in the resolution?

The compliance officer, John, the assurance company, the advisers, the customers, the FCA.

Professional skills focus: Assimilating and using information

The worked example above shows the sort of information that you will need to glean from the question's scenario and exhibits. Remember that there may well be several ethical issues that you need to identify and to do this you may need to combine information from the scenario and exhibits. Try to identify all the issues from the information provided, as there will be a limit to the number of marks you can earn from each

2.2 Corrupt Lloyd's syndicates

Definition

Lloyd's Name: Signs up for unlimited liability against insurance claims, and receives shares of profits from the broker syndicate they place their name against.

Lloyd's of London built a reputation as the place to insure practically anything, but the reputation and integrity of Lloyd's took a catastrophic hit in the 1980s as a result of the asbestos scandal.

In the US, large settlements on asbestos and pollution (APH) policies led to huge claims. A number of US states accused Lloyd's of large-scale fraud, particularly 'the apparent withholding of knowledge' regarding the level of asbestos and pollution claims.

Lloyd's was accused of encouraging investors to take on liabilities, even though the market was aware of the outstanding colossal claims that were being made which dated back decades.

Lloyd's claimed that the asbestos claims were hard to predict as they affected workers many years before they actually made the claim.

For example, a factory worker from the 1960s that was exposed to asbestos may have only developed health issues many years later, resulting in the suing of his employer for compensation:

- The employer would then claim for insurance on a policy drawn up 20 years beforehand, before the real risks associated with asbestos were known.
- The ultimate result was the bankruptcy of thousands of investors in Lloyd's syndicates as a result of the massive claims being made.

Archaic accounting

The syndicates lasted for one year only and each year was accounted for separately and, despite their continuing nature, there would be numerous separate incarnations of the same syndicate.

- Liabilities could be carried over each year because of the way profits and losses were accounted.

- The reinsurance-to-close mechanism resulted in the current syndicate members having to pick up the bill for policies written many years previously.
- Many market participants felt this was an unfair system that had not been properly explained to them before investing.

Perhaps one of the most controversial factors of the scandal is the policy dubbed **'recruit to dilute'**, where some Lloyd's officials were said to have deliberately sought new **'Names'** in advance of the forthcoming asbestos claims.

This was reportedly done in the full knowledge that there was an impending wave of claims over asbestos.

In the subsequent court cases over the losses, claims of 'recruit to dilute' were rejected, although the judge said that the Names at Lloyd's that had lost their money were 'the innocent victims … of staggering incompetence'.

The result of all these issues was that:

- many names that were exposed to the asbestos claims lost vast sums of money;
- many were declared bankrupt as a result of the unlimited liability of the policies; and
- as a direct result, in the aftermath, new Names at Lloyd's that joined after 1994 did so with limited liability.

At the same time, financial requirements for underwriting were also reformed, with checks made to ensure there were enough liquid assets available to back any potential losses.

2.3 Insurance spirals

Definition

Insurance spirals: The best way to understand a spiral is through a simple example. Imagine that direct property insurers in the Caribbean reinsure themselves in the London market. Lloyd's syndicates A and B in turn agree to protect the London market reinsurers, each for $5 million in excess of $1 million for losses arising out of one occurrence. A and B then reinsure each for their interests for $3 million excess of $3 million, also for losses arising out of one occurrence.

Characteristics of insurance spirals

In a normal situation when an insurer (or reinsurer) makes a claim on a reinsurance policy, the recovery does not lead to any further claims on that insurer.

In an insurance market spiral, however, claims made by reinsurers at one level result in the same reinsurers receiving additional claims under reinsurance policies that they have written.

Since the reinsurers in question have already received claims in excess of their deductibles from the particular loss event, provided that they have sufficient reinsurance cover in place the additional claims they receive then trigger further claims by them on higher layers of reinsurance cover.

Definition

Deductibles: The amount for which the insured is liable on each loss, injury, etc before an insurance company will make payment.

This situation is likely to occur when reinsurers seek to protect their own positions by purchasing XL reinsurance cover, and at the same time write XL (excess of loss) reinsurance policies for other reinsurers who are also likely to be affected by the same loss events.

In practice spirals most often occur when reinsurers provide cover for each other on similar lines of business, when the majority of the applicable reinsurance is XL cover and when retrocession business includes cover for claims arising from XL business (ie, it is XL on XL business).

In these conditions the reinsurance claims generated from insured losses in excess of the primary insurers' and reinsurers' deductibles are passed on in full, and continue to recirculate until some reinsurer runs out of cover.

These conditions applied to syndicates at Lloyd's and many other members of the London market in the second half of the 1980s: they participated in both direct and reinsurance business, and provided mutual reinsurance and retrocession cover for each other, with the result that claims arising from the same loss event were passed to and fro within the group.

Insurance spirals therefore serve to concentrate risk, rather than disperse it.

In an insurance spiral the direct connection between the level of insured losses and the triggering of claims on any given layer of reinsurance is broken. The total of claims is inflated by the recirculation of claims amongst insurers.

Because the reinsurance is generally purchased in layers whenever an insurer's retentions have been exceeded, but its reinsurance cover has not been exhausted, the further reinsurance claims arising from a single loss event are passed on in full. This means that even a relatively minor catastrophe may trigger claims under relatively high layers of reinsurance cover.

This means that the normal relationship between the layer of reinsurance cover and the probability of a claim being made is undermined.

When the link between the size of the original loss and the probability of a claim being made on any layer of reinsurance is broken it is impossible to make an objective estimate of the probability of a claim without detailed knowledge of the structure of the intervening reinsurance.

2.4 Mis-selling

Definition

Mis-selling: The deliberate, reckless, or negligent sale of products or services in circumstances where the contract is either misrepresented, or the product or service is unsuitable for the customer's needs. For example, selling life insurance to someone who has no dependants is regarded as mis-selling.

Mis-selling means that the customer is provided with unsuitable advice, the risks are not explained to the customer or they were not given the information that they needed, and ended up with a product that wasn't right for them.

The person who advises a consumer to buy must recommend something suitable for their needs, and explain properly what it can and can't do. The adviser should make sure that the consumer is fully aware of the risks.

Examples of the ways that payment protection insurance (PPI) was mis-sold:

- An individual was unemployed or retired when they were sold the PPI.
- The customer was told that PPI was compulsory.
- The customer was pressured into buying the PPI.
- Nobody fully explained the terms and conditions (small print).
- The customer wasn't told the rules about pre-existing medical conditions.

Mis-selling in this context can apply to most types of assurance policies and has often been blamed on the 'target driven' culture of banks and assurance companies.

ICAEW provides a framework for identifying and resolving ethical issues, but please be aware that for exam purposes it will **not** be sufficient to answer relevant questions by simply stating 'refer to the ICAEW framework'.

2.5 Uberrimae fidei and the Consumer CIDRA 2012

Insurance contracts used to include the concept of **uberrimae fidei** or **utmost good faith**. This places a duty on the parties to disclose all material facts of relevance to the contract. Thus an individual taking out medical insurance would have the obligation to disclose any matters related to their health that might be material to the insurer establishing the risk related to the policy. This could include a great deal of information including past medical history, medical history of parents and participation in high risk sport. One could also argue that it would also include the fact that the individual was experiencing symptoms consistent with a condition not yet diagnosed. Effectively this doctrine placed a very high ethical standard on the duty of the parties to disclose information.

The failure of an insured to act in accordance with *uberrimae fidei* could invalidate the insurance contract. For this to be the case there was no requirement to prove that an incorrect statement or omission was intentional.

Many consumer advocates considered it unfair that the insurance contract could be invalidated by the insured failing to ask a question that they had never been asked, or unknowingly giving a false or incomplete answer. Additionally it was open to abuse by unethical insurers who could seek to identify an undisclosed material fact in order to invalidate a policyholder's claim.

As a result of these concerns the **Consumer Insurance (Disclosure and Representations) Act 2012, often abbreviated to CIDRA 2012** stated that *uberrimae fidei* would no longer be applicable to consumer insurance contracts. The Act redefines the duty of disclosure such that insurers will generally only be able to decline a claim if the policyholder **deliberately or recklessly** gave incorrect or incomplete information when answering questions about their circumstances.

Thus the changes introduced by CIDRA 2012 (discussed more fully in Chapter 1) aim to establish a fairer, more ethical basis for the duty of disclosure by the consumer taking out an insurance policy.

2.6 ICAEW framework – how to resolve ethical problems

(a) **Gather the relevant facts and identify the problems**

- Do I have all the facts relevant to the situation?
- Am I making assumptions? If so, could facts be identified to replace these assumptions?
- Is it really your problem? Can anybody else help?

(b) **Identify the affected parties**

- Who are the individuals, organisations and key stakeholders affected?
- In what way are they affected?
- Are there conflicts between different stakeholders?
- Who are your allies?

(c) **Consider the ethical issues involved**

- Have you referred to ICAEW's Code of Ethics?
- What are the professional, organisational and personal ethics issues?
- Would these ethical issues affect the reputation of the accountancy profession?
- Would these ethical issues affect the public interest?

(d) **Identify which fundamental principles are affected**

- What are the threats to compliance with the fundamental principles of:
  - integrity
  - objectivity
  - professional competence and due care
  - confidentiality
  - professional behaviour
- Have you considered the following threats?
  - Self interest
  - Self-review
  - Advocacy
  - Familiarity
  - Intimidation
- If so, are the threats to compliance with the fundamental principles clearly insignificant?
- Are there safeguards which can eliminate or reduce the threats to an acceptable level? Safeguards can be created by:
  - profession, legislation and regulation
  - work environment
  - individual

(e) **Refer to the employing organisation's internal procedures**

- Do your organisation's policies and procedures provide guidance on the situation?
- How can you escalate concerns within the organisation? Who should be involved, in what role and at what stage?
- Does the organisation have a whistleblowing procedure?
- At what point should you seek guidance from external sources such as ICAEW?

(f) **Consider and evaluate alternative courses of action**

You should consider:

- your organisation's policies, procedures and guidelines
- applicable laws and regulation
- universal values and principles generally accepted by society
- consequences
- test your proposed course of action

Ask yourself the following questions:

- Have all the consequences associated with the proposed course of action been discussed and evaluated?
- Is there any reason why the proposed course of action should not stand the test of time?
- Would a similar course of action be undertaken in a similar situation?
- Would the suggested course of action stand to scrutiny from peers, family and friends?

(g) **Implement the course of action and monitor its progress**

When faced with an ethical issue, it may be in your best interests to document your thought processes, discussions and the decisions taken. Written records will be useful if you need to justify your course of action, as the final decision may rest with you.

Professional skills focus: Structuring problems and solutions

Using this methodology will ensure that you adopt a well-structured approach to resolving an ethical conflict. Without this, it is easy to produce an answer which lacks the necessary clarity to score well.

Definition

Payment protection insurance (PPI): Also known as credit insurance, credit protection insurance, or loan repayment insurance, PPI an insurance product that enables consumers to insure repayment of loans if the borrower dies, becomes ill or disabled, loses a job, or faces other circumstances that may prevent them from earning income to service the debt.

2.7 Prohibition of certain risks (eg, sanctions)

The UK financial sanctions regime plays an important part in delivering the Government's foreign policy objectives. It is also used by the Government to prevent and suppress the financing of terrorism and terrorist acts.

The FCA's role is to ensure that the firms it supervises have adequate systems and controls to comply with the UK financial sanctions regime.

In 2010, the FCA fined members of the Royal Bank of Scotland Group (RBSG) £5.6 million for failing to have adequate systems and controls in place to prevent breaches of UK financial sanctions.

Market Abuse Regulation (MAR) is designed to strengthen the existing UK market abuse framework by extending its scope to new markets, new platforms and new behaviours. It contains prohibitions for insider dealing and market manipulation, and provisions to prevent and detect these. It came into force on 3 July 2016.

2.8 Identifying ethical issues including prioritisation and actions to take

When initiating either a formal or informal conflict resolution process, the following factors, either individually or together with other factors, may be relevant to the resolution process:

- Relevant facts
- Ethical issues involved
- Fundamental principles related to the matter in question
- Established internal procedures
- Alternative courses of action

Having considered the relevant factors, a professional accountant shall determine the appropriate course of action, after assessing the consequences of each possible course of action.

If the matter remains unresolved, the accountant may wish to consult with other appropriate persons within the firm or employ a professional organisation for help in obtaining a resolution.

Where a matter involves a conflict with, or within, an organisation, an accountant shall determine whether to consult with those charged with governance of the organisation, such as the board of directors or the audit committee, and document this approach.

It may be in the best interests to consider obtaining professional advice from the relevant professional body or from legal advisers.

Guidance can generally be obtained on ethical issues without breaching the fundamental principle of confidentiality if the matter is discussed with the relevant professional body on an anonymous basis, or with a legal adviser under the protection of legal privilege.

For example, a professional accountant may have encountered a fraud, the reporting of which could breach the professional accountant's responsibility to respect confidentiality.

If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional accountant shall refuse to remain associated with the matter creating the conflict and determine whether, in the circumstances, it is appropriate to withdraw from the engagement team or specific assignment, or to resign altogether from the engagement, the firm or the employing organisation.

3 Using the IESBA/ICAEW codes to resolve ethical dilemmas

Section overview

- Professional accountants may be required to resolve ethical dilemmas using the IESBA/ICAEW codes.
- The codes provide advice and guidance.

4.1 Identifying conflicts

When evaluating compliance with the fundamental principles, a professional accountant may be required to resolve a conflict in complying with them.

The professional accountant may face pressure to:

- act contrary to law or regulation;
- act contrary to technical or professional standards;
- facilitate unethical or illegal earnings management strategies;
- lie to or otherwise mislead others, in particular:
  - the auditor of the employing organisation
  - regulators

- issue, or otherwise be associated with, a financial or non-financial report that materially misrepresents the facts, for example:
  - financial statements
  - tax compliance
  - legal compliance
  - reports required by securities regulators.

4.2 Dealing with conflicts

When dealing with such a conflict resolution the following should be considered:

- Relevant facts
- Relevant parties
- Ethical issues involved
- Fundamental principles related to the matter in question
- Established internal procedures
- Alternative courses of action

In this case an individual should:

- determine the appropriate course of action that is consistent with the fundamental principles;
- weigh up the possible consequences of each course of action;
- consult with other appropriate persons if the matter remains unresolved;
- obtain professional advice from the Institute or legal advisers, if it cannot be resolved; and
- finally if it remains unresolved refuse to remain associated with the matter creating the conflict.

5 *Ethical safeguards*

Section overview

- Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances and relationships.
- The nature and significance of the threats may differ depending on whether they arise in relation to the provision of services to an audit client and whether the audit client is a public interest entity, an assurance client that is not an audit client, or a non-assurance client.

6.1 Overview

Safeguards seek to reduce or eliminate threats. They fall into three categories:

Profession

These include:

- education and training including CPD requirements
- setting of corporate governance regulations and professional standards
- monitoring of professional work including disciplinary proceeding

Work environment

There are many examples which include:

- internal control systems
- review procedures
- disciplinary procedures
- organisational codes of ethics

- separate reviews and reporting for key engagements

Individual

These include:

- complying with professional standards
- maintaining records of contentious issues
- mentoring
- contacting professional bodies with queries

6.1.1 The use of safeguards

- Safeguards are necessary when the auditor concludes that the identified threats are at a level at which compliance with the fundamental principles is compromised.
- In other words, safeguards should be applied, when necessary, to eliminate the threats or reduce them to an acceptable level.
- Safeguards are created by the profession, legislation or regulation.

This may include the requirements of professional standards, corporate governance, regulations, and education and training of auditors.

Safeguards in the work environment – the IESBA Code gives examples of two types of safeguards in the work environment:

- Those that are **firm-wide**, and those that are **engagement-specific**

Examples of firm-wide safeguards include, but are not limited to:

- policies and procedures to implement and monitor quality control of engagements
- policies and procedures that will enable the identification of interests or relationships between the firm or members of engagement teams and clients
- policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single client

6.2 Ethical threats and safeguards

An **ethical threat** is a situation where a person or corporation is tempted not to follow their code of ethics.

An **ethical safeguard** provides guidance or a course of action which attempts to remove the ethical threat.

Under ISA 260, an external auditor must report all threats to their independence to those charged with governance, together with the safeguards that have been put in place to manage that threat to independence. The **audit committee** comprised of independent non-executive directors will then normally decide whether the external auditor is sufficiently independent, or whether there is a risk of 'auditor capture' by the executive directors, necessitating a change in external auditor.

The professional accountant must always be aware that fundamental principles may be compromised and therefore look for methods of mitigating each threat as it is identified.

Threats fall into one or more of the following categories:

- Self-interest
- Self-review
- Advocacy
- Familiarity
- Intimidation

Examples of circumstances that create self-interest threats for a professional accountant in public practice include:

- a member of the assurance team having a direct financial interest in the assurance client
- a firm having undue dependence on total fees from a client
- a member of the assurance team having a significant close business relationship with an assurance client
- a firm being concerned about the possibility of losing a significant client

- a member of the audit team entering employment negotiations with the audit client
- a firm entering into a contingent fee arrangement relating to an assurance engagement
- a professional accountant discovering a significant error when evaluating the results of a previous professional service performed by a member of the professional accountant's firm

Examples of circumstances that create other threats for a professional accountant in public practice include the following:

- The client accepting audit adjustments recommended by the external auditor creates a self-review threat. This is perhaps not obvious, but when an external auditor identifies an error in the financial statements and requests a change, the auditor is (in effect) partially preparing the financial statements. For a public interest entity such as an insurance company, this sort of direct assistance with the preparation of the financial statements is prohibited. This creates rather a logical conundrum, as it would be somewhat absurd for the auditor to tell the client that there is an error, but decline to tell the client what the error is. A suitable solution is often to have all audit adjustments reviewed by the engagement review partner before the audit opinion is issued, or ideally before the amendment to the financial statements is agreed with the client. Care must be taken that excessive consultation with the review partner does not make the review partner a member of the audit team. If this happens, a new review partner must be appointed.
- Assistance with the preparation of models for determining subjective items, such as insurance liabilities. The UK FRC has indicated that it would normally expect only audit firms that have access to in-house actuarial services should take on the audit of insurance companies. This in-house expertise should be used only by the external audit team only and not by the client.
- Auditors of insurance companies tend to be rather specialist, with most firms of ICAEW Chartered Accountants declining to accept such specialist work. This can mean that the pool of insurers and auditors is somewhat small. There can therefore be a risk that a firm is auditor to two insurers, who have business dealings with each other, such as auditing both a direct insurer and its reinsurer. If information is obtained by the auditor during the audit of one company, that information cannot be used as audit evidence on the audit of another insurance, unless it can be shown that it is:
  - general industry knowledge ie, not specific; or
  - would be obtainable by some other means, without the position of being auditor to the other company.

To use audit evidence obtained by being in the privileged position of being auditor, or advisor, to both companies would be a breach of the auditor's fundamental ethical duty of confidentiality.

Safeguards that may eliminate or reduce threats to an acceptable level fall into two broad categories:

- Safeguards created by the profession, legislation or regulation; and
- Safeguards in the work environment.

Examples of ethical threats and safeguards

Ethical threat	Safeguard
Conflict between requirements of the employer and the fundamental principles. For example, acting contrary to laws or regulations or against professional or technical standards. (**Intimidation** threat)	• Obtaining advice from the employer, professional organisation or professional adviser • The employer providing a formal dispute resolution process • Legal advice
Preparation and reporting on information Accountants need to prepare/report on information fairly, objectively and honestly. However, the accountant may be pressurised to provide misleading information. (**Intimidation** threat)	• Consultation with superiors in the employing company • Consultation with those charged with governance • Consultation with the relevant professional body
Having sufficient expertise	• Obtain additional advice/training • Negotiating more time for duties

Ethical threat	Safeguard
Accountants need to be honest in stating their level of expertise – and not mislead employers by implying they have more expertise than they actually possess. Threats that may result in lack of expertise include time pressure to carry out duties, being provided.	• Obtaining assistance from someone with relevant expertise
Financial interests Situations where an accountant or close family member has financial interests in the employing company. Examples include the accountant being paid a bonus based on the financial statement results which he is preparing, or holding share options in the company. (**Self-interest** threat)	• Remuneration being determined by other members of management • Disclosure of relevant interests to those charged with governance • Consultation with superiors or relevant professional body
Inducements – receiving offers Refers to incentives being offered to encourage unethical behaviour. Inducements may include gifts, hospitality, preferential treatment or inappropriate appeals to loyalty. Objectivity and/or confidentiality may be threatened by such inducements. (**Self-interest** threat)	• Do not accept the inducement! • Inform relevant third parties such as senior management and professional association (normally after taking legal advice)
Inducements – giving offers Refers to accountants being pressurised to provide inducements to junior members of staff to influence a decision of obtaining confidential information. (**Intimidation** threat)	• Do not offer the inducement! If necessary follow the conflict resolution process
Confidential information Accountants should keep information about their employing company confidential unless there is a right or obligation to disclose, or they have received authorisation from the client. However, the accountant may be under pressure to disclose information as a result of compliance with legal processes such as anti-money laundering/terrorism – in this situation there is a conflict between confidentiality and the need for disclosure.	• Disclose information in compliance with the relevant statutory requirements eg, money laundering regulations
Whistleblowing Situations where the accountant needs to consider disclosing information, where ethical rules have been broken by the client.	Follow the disclosure provisions of the employer eg, report to those responsible for governance. Otherwise disclosure should be based on assessment of: legal obligations, whether members of the public will be adversely affected, gravity of the matter, likelihood of repetition, reliability of the information, reasons why employer does not want to disclose.

Professional skills focus: Concluding, recommending and communicating

Ethics requirements in exam questions may ask you to come to a number of conclusions, such as identify the ethical issues, recommend actions and specify by whom the action should be taken. To maximise your marks, it is essential that you address all parts of such a requirement and that you clearly communicate which part you are answering.

6.3 Exercising judgement

A professional accountant in public practice shall exercise judgement:

- to determine how best to deal with threats that are not at an acceptable level:
  - whether by applying safeguards to eliminate the threat or reduce it to an acceptable level; or
  - by terminating or declining the relevant engagement.

In exercising this judgement, he shall consider whether a reasonable and informed third party, weighing all the specific facts and circumstances available would conclude:

- that the threats would be eliminated or reduced to an acceptable level by the application of safeguards; and
- that compliance with the fundamental principles is not compromised.

This consideration will be affected by matters such as the significance of the threat, the nature of the engagement and the structure of the firm.

In the work environment, the relevant safeguards will vary depending on the circumstances. Work environment safeguards comprise firm-wide safeguards and engagement-specific safeguards.

Examples of firm-wide safeguards in the work environment include:

- Leadership of the firm that stresses the importance of compliance with the fundamental principles
- Leadership of the firm that establishes the expectation that the members of an assurance team will act in the public interest
- Policies and **procedures to**:
  - implement and monitor quality control of engagements;
  - enable the identification of interests or relationships between the firm or members of engagement teams and clients;
  - monitor and, if necessary, manage the reliance on revenue received from a single client; and
  - prohibit individuals who are not members of an engagement team from inappropriately influencing the outcome of the engagement.
- **Documented policies**:
  - regarding the need to identify threats to compliance with the fundamental principles, evaluate the significance of those threats, and apply safeguards to eliminate or reduce the threats to an acceptable level; or
  - internal policies and procedures requiring compliance with the fundamental principles.

When appropriate safeguards are not available or cannot be applied, terminate or decline the relevant engagement.

- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client
- Timely communication of a firm's policies and procedures, including any changes to them, to all partners and professional staff, and appropriate training and education on such policies and procedures
- Designating a member of senior management to be responsible for overseeing the adequate functioning of the firm's quality control system
- Advising partners and professional staff of assurance clients and related entities from which independence is required
- A disciplinary mechanism to promote compliance with policies and procedures
- Published policies and procedures to encourage and empower staff to communicate to senior levels within the firm any issue relating to compliance with the fundamental principles that concerns them

6.4 Ethical considerations related to Public Interest Entities

It is a provision of the ICAEW Code of Ethics that members of audit teams and firms shall be independent of audit clients.

Independence comprises independence of mind ie, acting with integrity and exercising objectivity and professional scepticism. It also comprises independence in appearance ie, the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's, or a member of the audit team's, integrity, objectivity or professional scepticism has been compromised.

Section 290 of the Code of Ethics contains **additional independence provisions** when the client is a **public interest entity**.

Public interest entities are all listed entities and any entity defined by regulation or legislation as a public interest entity. Firms are encouraged to determine whether to treat entities as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered include:

- the nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples may include financial institutions, such insurance companies and banks and pension funds;
- size; and
- number of employees.

Financial institutions such as insurers are therefore Public Interest Entities and these additional ethical provisions apply.

Threat to independence	Mitigation of threat
Employment with an audit client Familiarity or intimidation threats are created when a key audit partner joins the audit client that is a public interest entity as a director or as an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.	Subsequent to the partner ceasing to be a key audit partner, the public interest entity had issued audited financial statements covering a period of not less than 12 months and the partner was not a member of the audit team with respect to the audit of those financial statements.
An intimidation threat is created when the individual who was the firm's senior or managing partner joins an audit client that is a public interest entity as an employee in a position to exert significant influence over the preparation of the entity's accounting records or its financial statements; or a director or officer of the entity.	Independence would be deemed to be compromised unless 12 months have passed since the individual was the senior or managing partner of the firm.
Long association of senior personnel with an audit client The long association of other partners with an audit client that is a public interest entity creates familiarity and self-interest threats. The significance of the threats will depend on factors such as: • how long any such partner has been associated with the audit client; • the role, if any, of the individual on the audit team; and • the nature, frequency and extent of the individual's interactions with the client's management or those charged with governance.	An individual shall not be a key audit partner for more than seven years. After such time, the individual shall not be a member of the engagement team or be a key audit partner for the client for two years. During that period, the individual shall not participate in the audit of the entity, provide quality control for the engagement, consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events or otherwise directly influence the outcome of the engagement.

Threat to independence	Mitigation of threat
The significance of the threats shall be evaluated and safeguards applied when necessary to eliminate the threats or reduce them to an acceptable level.	
Preparing accounting records and financial statements Except in emergency situations, a firm shall not provide to an audit client that is a public interest entity accounting and bookkeeping services, including payroll services, or prepare financial statements on which the firm will express an opinion or financial information which forms the basis of the financial statements.	A firm may provide accounting and bookkeeping services if the personnel providing the services are not members of the audit team and the divisions for which the service is provided are collectively immaterial to the financial statements on which the firm will express an opinion or the services relate to matters that are collectively immaterial to the financial statements of the division.
Valuation services A firm shall not provide valuation services to an audit client that is a public interest entity if the valuations would have a material effect, separately or in the aggregate, on the financial statements on which the firm will express an opinion.	
Tax calculations for the purpose of preparing accounting entries Except in emergency situations, a firm shall not prepare tax calculations of current and deferred tax liabilities (or assets) for the purpose of preparing accounting entries that are material to the financial statements on which the firm will express an opinion.	
Internal audit services A firm shall not provide internal audit services that relate to a significant part of the internal controls over financial reporting, financial accounting systems that generate information that is, separately or in the aggregate, significant to the client's accounting records or financial statements on which the firm will express an opinion; or amounts or disclosures that are, separately or in the aggregate, material to the financial statements on which the firm will express an opinion.	
IT systems services A firm shall not provide services involving the design or implementation of IT systems that (a) form a significant part of the internal control over financial reporting or (b) generate information that is significant to the client's accounting records or financial statements on which the firm will express an opinion.	
Recruiting services A firm shall not provide recruiting services with respect to a director of the entity or senior management in a position to exert significant	

Threat to independence	Mitigation of threat
influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.	

6.4.1 EU Audit Directive

In addition to the independence provisions of the code above, the **EU Audit Directive** which came into effect in the UK, in June 2016, imposes additional requirements with respect to Public interest Entities. The Directive now defines Public Interest Entities to include insurance companies of all types (life, non-life and reinsurers) in the EU are covered by these provisions regardless of whether listed or not.

Insurers will be covered by the following additional provisions of the EU Audit Directive:

Audit Rotation – There is a requirement for Public interest Entities to retender every 10 years with a 20-year maximum tenure for each audit firm.

Restrictions on non-audit services – The directive contains a list of prohibited non-audit services which cannot be performed by a Public interest Entity's statutory auditor. These services cannot be provided to the entity, its parent undertaking or controlled undertakings within the EU. This list of prohibited services basically includes those in the existing independence provisions of the Code of Ethics covered above, but with fewer exemptions and caveats.

Cap on non-audit services – A limit of 70% of the average audit fee paid for the last three years will apply for all non-audit services provided by a statutory auditor. UK audit firms can apply for a short term exemption from this fee cap from the FRC.

6.5 Ethical issues facing insurers

Insurers also face specific ethical dilemmas and challenges which they need to manage in such a way to ensure fair treatment for customers. For example:

- Insurance is based upon the concept of the pooling of risk. However, insurers also seek information from policyholders to identify the degree of risk in writing the policy in order to establish an appropriate premium. It could be argued that this is to ensure that the risk is included in the correct pool and priced accordingly. With increasing information becoming available through techniques such as data mining and DNA analysis, it is becoming possible to ever more accurately predict an individual's medical risk. Taken to its conclusion, the increasing eradication of uncertainty reduces the extent to which risk is pooled and could create a class of 'uninsurables', individuals at such a high medical risk that they cannot obtain cover. So the challenge is to balance the perceived social need to provide insurance cover for all those that seek it against the need to accurately price risk.
- Insurers need to verify that claims are valid before paying them. Insurance fraud is a significant problem for the industry and for its customers who ultimately end up paying for it. Against this must be set the need to behave fairly and not make establishing a claim so onerous that policyholders are dissuaded from pursuing claims.
- Related to the above is the fact that insurers typically delay paying a claim for a period to establish its veracity and in some cases, such as car theft, establish that the goods won't be recovered. There is clearly a cash flow benefit to insurers delaying paying claims as long as possible. However, from the point of view of the customer a delay in receiving the claim to make good their loss is undesirable.
- Insurance intermediaries are usually paid on commission for products sold. There is a danger that in order to maximise their income they sell inappropriate products to customers. This is typical of the conflicts of interest for any sales intermediary paid on commission and is exacerbated by the complexity of insurance products.
- A similar conflict exists for Lloyd's brokers which are also intermediaries remunerated on the basis of the policies which they get underwritten for their clients. Lloyd's brokers might therefore be tempted to understate the risks to underwriters in order to increase the amount of business done.

In many of the cases above the regulator must comply with regulatory or legal requirements designed to manage the ethical conflict appropriately. Insurance firms establish internal procedures over aspects of their business such as claims handling and underwriting to ensure such issues are handled fairly, in compliance with the regulatory regime and in a consistent manner.

Additionally there is a market imperative for insurance companies to be perceived as fair. You may have noticed how many insurance company TV ads stress an insurer's ability to be there to help its customers, meeting claims swiftly and fairly and resolving the policyholder's problems. This reflects the importance of an insurer's reputation for fairness. An insurer which acts unethically by continually fighting valid claims and delaying payments will inevitably suffer from a poor reputation. In the internet age 'word of mouse' through social media has accelerated and amplified the negative impact of the dissatisfied customer. Thus, in the long run, doing business ethically also makes financial sense for insurance companies and their shareholders.

7 Responsibilities of auditors to report regulatory issues

Section overview

- The auditor of a regulated insurer generally has additional reporting responsibilities in addition to the responsibility to report on financial statements.
- The auditor should ensure that matters are reported in a proportionate manner in accordance with professional guidance and regulatory and legal responsibilities.

8.1 Overview

The responsibility to provide a report on matters specified in legislation or by a regulator. The auditor is required to carry out appropriate procedures sufficient to form an opinion on the matters concerned. These procedures may be in addition to those carried out to form an opinion on the financial statements and:

- relate to **a statutory duty to report** information of **material significance** to the regulators' functions that come to the auditor's attention in the course of the audit work. The most important authority for this is section 342 FSMA 2000, as described earlier; and
- the auditor has **no responsibility** to carry out procedures to **search out the information relevant** to the **regulator**. This form of report is derivative in nature, arising only in the context of another set of reporting responsibilities, and is initiated by the auditor on discovery of a reportable matter.

8.2 Identifying matters requiring a report direct to regulators

Where an apparent breach of statutory or regulatory requirements comes to the auditor's attention, the auditor shall:

- obtain the evidence available to assess its implications of the auditor's responsibilities;
- determine whether there is reasonable cause to believe that the breach is of **material significance** to the regulator; and
- consider whether the apparent breach is criminal conduct that gives rise to criminal property and should be reported to the specified authorities.

8.3 The auditor's statutory duty to report direct to regulators

When the auditor concludes, after appropriate discussion and investigations, that the matter gives rise to a statutory duty to make a report, he should bring the matter to the attention of the regulator as soon as practicable in a form and manner which will facilitate appropriate action.

- When the initial report is made orally, the auditor shall confirm this report in writing to the regulator.

- When this matter casts doubt on the integrity of those charged with governance or competence to conduct the business, the auditor should make the report to the regulator as soon as practicable, without informing those charged with governance in advance.

8.4 The auditor's right to report direct to regulators

When a matter comes to the auditor's attention which does not give rise to a statutory duty to report, but may be relevant to the regulator's exercise of its functions, the auditor shall:

- consider whether the matter should be brought to the attention of the regulator under the terms of the appropriate legal provisions; and if so
- advise those charged with governance that the matter should be drawn to the regulators' attention.

Where the auditor is unable to obtain adequate evidence that those charged with governance have not informed the regulator of the matter, the auditor shall make a report direct to the regulator as soon as practicable.

8.5 Options for reporting matters of concern to the PRA

It would not be correct to imagine that the PRA is in receipt of a deluge of formal reports from auditors under s.342 FSMA 2000. The PRA would be expected to receive only a handful of such reports each year. In the event that a matter of concern comes to the attention of the auditor of an insurer that relates to a firm's regulatory responsibilities there is, in fact, a spectrum of actions that may be considered as an appropriate and proportionate response to the nature and seriousness of the issue.

- If the matter is **not of material significance** to the regulator's activities the auditor may not feel that the matter need be raised with the PRA at all and instead may report it to the firm's **line management** in accordance with ISA 265 or to **those charged with governance** in accordance with ISA 260.
- Alternatively the auditor may also choose to discuss it with the PRA informally at a **routine bilateral meeting** with the lead supervisor. Such bilateral meetings may occur regularly depending upon the PRA risk category of the firm and its PIF status, as discussed in Chapter 12.
- It should also be remembered that, as described in Chapter 12, the auditor has a **specific duty** under the Auditors part of the **PRA rulebook** to **report without delay** if the firm resigns as auditor, is removed, not reappointed or is disqualified from office. The report must state any matter that should be brought to the PRA's attention or the fact that there are none.
- Reporting directly to the regulator under s.342 FSMA 2000 is only required where the auditor has reasonable grounds to believe that the matter is of **material significance** to the regulator's functions. Auditors of smaller Solvency II firms and/or those with the lowest PIF status may not have a regular bilateral meeting with the lead supervisor, making reporting under s.342 more likely.

9 Whistleblowing

Section overview

- Whistleblowers are protected by the Public Interest Disclosure Act 1998 from detrimental action by employers.
- The PRA and FCA have rules on whistleblowing that require firms to have internal whistleblowing procedure which employees are informed of.

Whistleblowing involves confidential disclosure made by an employee or other person related to suspicions of wrongdoing by another person or the firm.

10.1 UK whistleblowing legislation

In the UK the **Public Interest Disclosure Act 1998 (PIDA)** introduced provision to protect workers from detrimental action as a result of a **'protected disclosure'** made to their **employer** or a **'prescribed person'**. The list of prescribed persons under the Act includes both the FCA and the PRA for matters related to their respective regulatory scopes. The worker is only protected when the disclosure is made in **good faith**. Protected disclosures include those that relate to criminal activity, failure to meet legal obligations or health and safety.

Under this legislation the whistleblower is protected against any detrimental action or threat of victimisation by their employer. In the event that the whistleblower is dismissed or suffers other detrimental action they are entitled to compensation.

However, it should be noted that this Act **does not protect a member of ICAEW from professional disciplinary action**. ICAEW has produced guidance on *Professional conduct in relation to defaults or unlawful acts* which provides advice to members on their responsibilities relating to defaults and unlawful acts encountered in the course of professional work and their position where disclosure is made. This guidance states that disclosure in the public interest (including, but not limited to, matters covered by PIDA) would not breach the member's ethical duty of confidentiality. Whistleblowing can be a complex area and members may wish to **seek advice** from a lawyer or contact the ICAEW Ethics advisory service before making such disclosure.

10.2 PRA and FCA rules on whistleblowing

The rulebooks of both the FCA and the PRA contain rules regarding the **obligation of firms** in respect of whistleblowing.

These rules were designed to build on and **formalise the good practice** in respect of whistleblowing that was already widespread in the financial services industry. They also aim to encourage a culture where individuals feel able to raise concerns and challenge poor practice and behaviour without fear of detrimental action against them.

The PRA rules on whistleblowing applicable to **insurers subject to the Solvency II** Directive require that a firm establish, maintain and implement appropriate and effective arrangements for the disclosure of **reportable concerns** by a person, including a firm's employee, internally through a **specific, independent and autonomous channel**.

A reportable concern is defined as:

- any matter that, if disclosed, would be the subject-matter of a **protected disclosure**, including a **breach of any rule**;
- a failure to comply with the **firm's policy and procedures**; and
- behaviour that has or is likely to have an adverse effect on the **firm's reputation or financial well-being**.

Employees must be informed of the availability of the internal channel for whistleblowing of reportable concerns. The employee must also be informed of the legal protection available in respect of a protected disclosure direct to the PRA of FCA and the means of so doing.

The FCA whistleblowing rules require that a firm:

- appoint a Senior Manager as a **whistleblowers' champion**;
- put in place **internal whistleblowing arrangements** able to handle all types of disclosure from all types of person;
- put text in settlement agreements explaining that **workers have a legal right** to blow the whistle;
- **inform** UK-based employees about the **whistleblowing services of the FCA and PRA**;
- present a **report** on whistleblowing to the board **at least annually**;
- inform the FCA if it loses an employment tribunal with a whistleblower; and
- require its appointed representatives and tied agents to **tell their UK-based employees** about the FCA whistleblowing service.

The FCA has in recent years taken a number of steps to encourage whistleblowers to come forward to the organisation, including conducting a detailed review of its whistleblowing procedures and increasing the resources dedicated to the area.

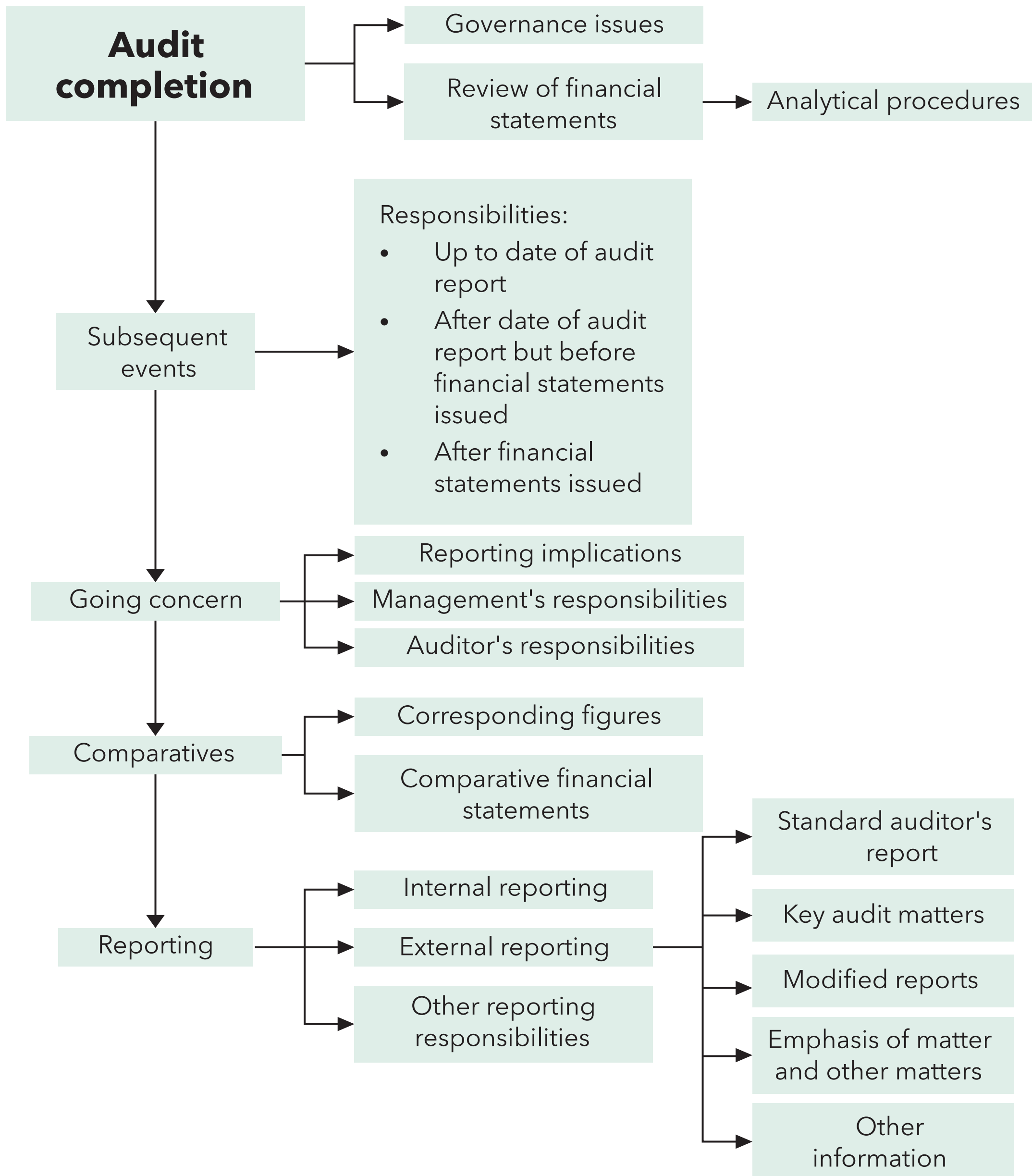
10.3 Ethical issues in whistleblowing

Although whistleblowing is an important legally protected right, there can be instances where whistleblowing is used by an individual as retribution for what they believe is mistreatment, such as redundancy or failure to secure promotion. It should be noted that the legal protection under PIDA is only afforded to a whistleblower making a disclosure in good faith. Thus an individual making such an unjustified disclosure in such circumstance is unlikely to enjoy the legal protection of PIDA against detrimental action.

Whistleblowing should not be thought of as the first option for those with concerns or grievances related to their employer. Even when an individual has an issue of genuine concern it will usually be more appropriate to report the matter internally through normal reporting lines. If it is felt that this action has not been successful, internal whistleblowing procedures should be considered before choosing to disclose the matter to an external prescribed person. Those who make disclosures to an external prescribed person without first considering the use of appropriate internal channels also expose themselves to the risk of detrimental action, without legal protection, if their disclosure is not considered to be in good faith.

Finally, it should be appreciated that the legal rights afforded to whistleblowers only override the implied or explicit contractual duty of confidentiality owed by employees to an employer in limited specified circumstances. Consequently, whistleblowing is not a step that should be taken lightly and careful consideration should be given to whether the matter reported is truly a matter of public, rather than merely personal interest.

Summary


Audit completion
Governance issues
Review of financial statements
Analytical procedures
Subsequent events
Responsibilities:
• Up to date of audit report
• After date of audit report but before financial statements issued
• After financial statements issued
Going concern
Reporting implications
Management's responsibilities
Auditor's responsibilities
Comparatives
Corresponding figures
Comparative financial statements
Reporting
Internal reporting
External reporting
Other reporting responsibilities
Standard auditor's report
Key audit matters
Modified reports
Emphasis of matter and other matters
Other information

Further question practice

1 Knowledge diagnostic

Before you move on to question practice, complete the following knowledge diagnostic and check you are able to confirm you possess the following essential learning from this chapter. It not, you are advised to revisit the relevant learning from the topic indicated.

Confirm your learning	Yes/No
(a) Do you understand how insurance business can give rise to specific ethical issues? (Topic 1)	
(a) Can you apply the ICAEW framework to resolve a conflict? (Topic 2)	
(a) Do you understand how an accountant in practice or business can be subject to an ethical threat and what safeguards can be applied? (Topic 3)	
(a) Do you understand when an auditor has a statutory duty to report a matter to the regulator? (Topic 4)	
(a) Can you identify when whistleblowing would be an appropriate course of action? (Topic 5)	

2 Question practice

Aim to complete all self-test questions at the end of this chapter. The following self-test questions are particularly helpful to further topic understanding and guide skills application before you proceed to the next chapter.

Question	Question Name	Learning benefit from attempting this question	Yes/No
Q3	Bad advice	Confirms that you understand a potential ethical issue when providing advice.	
Q4	Independence and objectivity	Ensures that understand how relationships can pose an ethical threat .	
Q5	Reporting	Check you know the key issue for determining if there is a statutory obligation for the auditor to report.	

Once you have completed these self-test questions, it is beneficial to attempt the following questions from the Question Bank for this module. These questions have been selected to introduce exam style scenarios to help you improve knowledge application and professional skills development before you start the next chapter.

Question	Question Name	Learning benefit from attempting this question	Yes/No
Q23 part 6 only	Sheraton Life	This question requires the application of ethical and regulatory issue to an insurer's remuneration policies.	
Q29 part 2 only	Clipeus Insurance	This question requires the application of ethical and regulatory issue to an insurer's remuneration policy.	
Q65 part 5 only	Welsh Life	This past exam question looks at ethical and regulatory issues as they apply to an insurer.	

Congratulations! You have completed your studies of the final chapter.

Self-test questions

Answer the following questions.

- It is common practice in the UK for parents to obtain cheaper car insurance for their children by obtaining a policy in their own name with the child as a named driver on the policy. What are the ethical issues in relation to this behaviour?

- Xavier claims for his Rolex watch he believes has been stolen from his locker at the gym. The insurance company pays out £1,200 on the claim. Before Xavier purchases a watch to replace the one stolen he finds the one he believed to have been stolen at the back of the glove compartment of his car and realises he must have taken it off prior to entering the gym. What is the ethical course of action for Xavier?

- A pension adviser encourages his clients to switch between pension providers on a frequent basis in order to maximise the commission that he earns. How would this activity be described?

- Carol is the audit senior on the audit of BOB Insurance plc. Give three examples of relationships with the audit client that could represent a threat to her independence and objectivity.

- Where the auditor of an insurer, in the course of their work, identifies unethical behaviour by the client or its staff, what is the key determinant of whether the auditor should report the matter direct to the insurer's regulator?

Now go back to the Introduction and ensure that you have achieved the Learning outcomes listed for this chapter.

Answers to Interactive questions

Answer to Interactive question 1

There are a large number of possibilities, of which the list below are examples:

- Reducing the amount of audit work from that planned in order to reduce costs
- Accepting an audit engagement without the appropriate resources and expertise available
- Accepting management estimates due to the implied threat that they will change auditors
- Failing to report required matters to the regulators for fear of adverse publicity
- Members of the audit team not performing their duties diligently; this would encompass activities such as phantom ticking
- The audit firm accepting a discount on its professional liability insurance not generally available

Answers to Self-test questions

1 This is a good example of a practice that, although widespread and accepted by many, is nonetheless unethical. This action known as 'fronting' involves a parent obtaining cheaper insurance for their child by misrepresenting themselves as the main driver. As well as being clearly unethical, such action is classified as an insurance fraud since the policyholder obtains the policy by knowingly providing false information to the insurer.

2 Xavier has acted in good faith in making the claim as he honestly believed that the watch had been stolen. However, now he has found that not to be the case, he has a duty to inform the insurer of this fact and should return the £1,200 received in respect of the claim. Failure to inform the insurance company and return the money is also likely to constitute a fraud.

The situation would be more complex if a longer period of time had elapsed before the watch was discovered and the replacement had been purchased. In this case Xavier should still report it to the insurance company. The rediscovered watch effectively belongs to the insurer who is likely to offer a number of alternatives to Xavier. He could be given the alternatives of handing over the watch to the insurer, buying the watch from the insurer or repaying the amount of the claim.

3 This is known as churning.

4 Examples (not exhaustive) include:

- She is currently interviewing for a job at BOB.
- She has a large shareholding in BOB.
- She has a close relative who is a director of BOB.
- She is involved in a legal dispute with BOB.

5 The issue identified must be reported if the auditor has **reasonable cause** to believe it is of **material significance** to the regulator.

Appendix

Tax Tables FA2020

Syllabus area: Administration

SUBMISSION DATES

Submission dates for 2020/21 personal self-assessment tax returns

Return filed online	Later of: 31 January 2022 3 months from the date of issue of return
Paper returns	Later of: 31 October 2021 3 months from the date of issue of return

Submission dates for corporation tax returns

Must be filed by 12 months from the end of the period of account.

Submission dates for PAYE information: Real Time Information

Information	**Filing date**
Full Payment Submission (FPS)	On or before the day the employee is paid
P60 (to employees)	31 May following the tax year end
P11D	6 July following the tax year end

PAYMENT DATES

Payment dates for income tax

Payment	**Filing date**
First interim payment (1)	31 January in the tax year
Second interim payment (1)	31 July following the tax year end
Balancing payment	31 January following the tax year end

(1) Interim payments are not required if the tax paid by assessment for the previous year was less than:

£1,000; or

20% of the total tax liability (income tax and Class 4)

Payment dates for capital gains tax

Capital gains tax is payable by 31 January following the tax year end.

Payment dates for corporation tax	
Corporation tax	Nine months and one day after the end of an accounting period
Corporation tax by instalments – large companies	The 14th day of months 7, 10, 13 and 16 counted from the start of a 12-month accounting period
Corporation tax by instalments – very large companies	The 14th day of months 3, 6, 9 and 12 counted from the start of a 12-month accounting period

Payment dates for VAT

	Due date
Electronic payment	7 calendar days after the last day of the month following the end of the return period
Direct debit payment	Collected automatically 3 working days after electronic payment due date

MAIN PENALTY PROVISIONS

PENALTIES FOR INCORRECT RETURNS

The penalties are a percentage of the potential lost revenue

Reason for penalty	Maximum penalty	Minimum penalty with unprompted disclosure	Minimum penalty with prompted disclosure
Careless action	30%	Nil	15%
Deliberate but not concealed action	70%	20%	35%
Deliberate and concealed action	100%	30%	50%

PENALTIES FOR FAILURE TO NOTIFY

Failures to notify chargeability to tax, or liability to register for tax that leads to a loss of tax will result in a penalty. The penalties are a percentage of the potential lost revenue.

Reason for penalty	Maximum penalty	Minimum penalty with unprompted disclosure		Minimum penalty with prompted disclosure	
Deliberate and concealed action	100%		30%		50%
Deliberate but not concealed action	70%		20%		35%
		>12m	<12m	>12m	<12m
Any other case	30%	10%	Nil	20%	10%

COMPANIES: PENALTIES

Offence	Maximum Penalty
Failure to notify chargeability within 12 months of end of accounting period	See above: penalties for failure to notify

Corporation tax: penalties for late filing of a corporation tax return

Offence	Penalty(1)
Late return, up to 3 months late	£100 fixed penalty, or £500 for persistent failure
Return more than 3 months late	£200 fixed penalty, or £1,000 for persistent failure
Return filed more than 18 months but less than 24 months after end of return period	Tax geared penalty of 10% of tax unpaid 18 months after end of return period
Return filed more than 24 months after end of return period	Tax geared penalty of 20% of tax unpaid 18 months after end of return period

(1) The tax geared penalty is charged in addition to the fixed penalty but only one of each type of penalty is charged.

INDIVIDUALS: PENALTIES

Offence	Maximum Penalty
Failure to notify chargeability by 5 October following tax year end	See above: penalties for failure to notify
Late payment of income tax or capital gains tax: (1)	
Unpaid 30 days after payment due date	5% of tax unpaid
Unpaid 6 months after payment due date	Further 5% of tax unpaid
Unpaid 12 months after payment due date	Further 5% of tax unpaid

(1) Late payment penalties do not apply to payments on account.

Income tax and CGT: penalties for late filing of a self-assessment return

Offence	Maximum Penalty
Late return	Immediate £100 fixed penalty
Return more than 3 months late	Daily fixed penalties of up to £10 per day for maximum 90 days
Return more than 6 months but less than 12 months late	Further tax geared penalty of 5% of tax due (minimum £300)
Return 12 months late	Further tax geared penalties apply (minimum £300): 100% if deliberate and concealed(1) 70% if deliberate but not concealed(1) 5% in all other cases

(1) These tax geared penalties are reduced for disclosure as per penalties for incorrect returns.

PAYE: penalties for late returns/ submissions

Number of employees	Monthly penalty
1 to 9	£100
10 to 49	£200
50 to 249	£300
250 or more	£400

If the form is more than three months late, an additional penalty is due of 5% of the tax and NIC that should have been reported.

Additionally, there is a £300 penalty per late P11D return, with an extra £60 per day charged if the delay continues.

PAYE: penalties for late payment

	No of late payments	% of tax unpaid(1)
	1st	nil
	2nd, 3rd & 4th	1%
	5th, 6th & 7th	2%
	8th, 9th & 10th	3%
Penalties for late payment of in-year PAYE depend on the number of defaults in the tax year	11th or more	4%
Where a penalty has been imposed and the tax remains unpaid at 6 months		5%(2)
Where a penalty has been imposed and the tax		5%(2)

remains unpaid at 12 months

(1) The percentage penalty is applied to the total amount that is late in the relevant tax month.

(2) The 6 month and the further 12 month penalties are in addition to the initial penalty for late payment.

VAT: penalties

Offence	Maximum Penalty
Failure to notify liability for registration or change in nature of supplies by person exempted from registration	See above: penalties for failure to notify

VAT: late payment or late filing – default surcharge

Default involving late payment of VAT in the surcharge period[1]	Surcharge as a percentage of the VAT outstanding at the due date
First	2%[2]
Second	5%[2]
Third	10%[3]
Fourth	15%[3]

(1) Default if late payment of VAT or filing of VAT return and surcharge liability notice issued, but default surcharge only applies on late payment.

(2) No surcharge if it would be less than £400.

(3) Minimum £30 payable.

VAT errors

An error made on a VAT return can be corrected on the next return provided it was not deliberate and does not exceed the greater of:

- £10,000 (net under-declaration minus over-declaration); or
- 1% x net VAT turnover for return period (maximum £50,000)

Alternatively, a 'small' error which is not deliberate may be corrected via the submission of form VAT652. Errors which are not 'small' or errors which are deliberate should be notified to HMRC on form VAT652.

RECORD KEEPING PENALTY

Offence	Maximum Penalty
Failure to keep and retain tax records	£3,000 per tax year / accounting period

INCOME TAX RATES: 2020/21

	Rate	Taxable income band
Main rates		
Basic rate	20%	£1 – £37,500
Higher rate	40%	£37,501 – £150,000
Additional rate	45%	Over £150,000
Savings rates		
Starting rate for savings	0%	£1 - £5,000
Savings income nil rate	0%	First £1,000 or £500
Savings basic rate	20%	Otherwise chargeable at basic rate

	Rate	Taxable income band
Savings higher rate	40%	Otherwise chargeable at higher rate
Savings additional rate	45%	Otherwise chargeable at additional rate
Dividends rates		
Dividend nil rate	0%	First £2,000
Dividend ordinary rate	7.5%	Otherwise chargeable at basic rate
Dividend upper rate	32.5%	Otherwise chargeable at higher rate
Dividend additional rate	38.1%	Otherwise chargeable at additional rate
Default rates		
Default basic rate	20%	
Default higher rate	40%	
Default additional rate	45%	

INCOME TAX RELIEFS	2020/21
Personal allowance	£12,500

CGT RATES

	2020/21
Gains falling within the remaining basic rate band	10%
Gains exceeding the basic rate band	20%

CORPORATION TAX RATES

	FY 2020
Tax rate	19%
Augmented profits limit for corporation tax payment dates – large companies	£1,500,000
Augmented profits limit for corporation tax payment dates – very large companies	£20,000,000

NATIONAL INSURANCE CONTRIBUTIONS

	2020/21		
NIC CLASS 1	Annual	Monthly	Weekly
Primary threshold (PT)	£9,500	£792	£183
Secondary threshold (ST)	£8,788	£732	£169
Upper earnings limit (UEL)	£50,000	£4,167	£962
Apprentice upper secondary threshold (AUST) for under 25s	£50,000	£4,167	£962
Upper secondary threshold (UST) for under 21s	£50,000	£4,167	£962

NIC CLASS 1			2020/21	
		Annual	Monthly	Weekly
Employment allowance (per year, per employer)	£4,000			
Class 1 Primary contributions on earnings between PT & UEL	12%			
Class 1 Primary contributions on earnings above UEL	2%			
Class 1 Secondary contributions on earnings above ST where employee aged 21 or over and not an apprentice under the age of 25	13.8%			
Class 1 Secondary contributions on earnings between ST & AUST for apprentices under the age of 25	0%			
Class 1 Secondary contributions on earnings above AUST for apprentices under the age of 25	13.8%			
Class 1 Secondary contributions on earnings between ST & UST for employees under the age of 21	0%			
Class 1 Secondary contributions on earnings above UST for employees under the age of 21	13.8%			
Class 1A contributions	13.8%			

	2020/21
NIC CLASS 2	
Normal rate	£3.05 pw
Small profits threshold	£6,475 pa
NIC CLASS 4	
Annual lower profits limit (LPL)	£9,500
Annual upper profits limit (UPL)	£50,000
Percentage rate between LPL & UPL	9%
Percentage rate above UPL	2%

VAT	
Standard rate of VAT	20%
Reduced rate of VAT	5%

Syllabus Area: Income Tax & NIC

INCOME TAX RATES: 2020/21	Rate	Taxable income band
Main rates		
Basic rate	20%	£1 – £37,500
Higher rate	40%	£37,501 – £150,000
Additional rate	45%	Over £150,000
Savings rates		

INCOME TAX RATES: 2020/21	Rate	Taxable income band
Starting rate for savings	0%	£1 - £5,000
Savings income nil rate	0%	First £1,000 or £500
Savings basic rate	20%	Otherwise chargeable at basic rate
Savings higher rate	40%	Otherwise chargeable at higher rate
Savings additional rate	45%	Otherwise chargeable at additional rate
Dividends rates		
Dividend nil rate	0%	First £2,000
Dividend ordinary rate	7.5%	Otherwise chargeable at basic rate
Dividend upper rate	32.5%	Otherwise chargeable at higher rate
Dividend additional rate	38.1%	Otherwise chargeable at additional rate
Default rates		
Default basic rate	20%	
Default higher rate	40%	
Default additional rate	45%	

INCOME TAX RELIEFS	2020/21
Personal allowance[1]	£12,500
Marriage allowance[2]	£1,250

(1) The personal allowance of any individual with adjusted net income above £100,000 is reduced by £1 for every £2 of adjusted net income above the £100,000 limit.

(2) A spouse or civil partner who is a basic rate taxpayer or who has income of less than the personal allowance is allowed to transfer £1,250 of their personal allowance (ie 10% rounded up to the next £10) to their spouse/civil partner provided the recipient spouse is a basic rate taxpayer.

CAPITAL ALLOWANCES

First year allowances available

100% on new and unused zero emissions goods vehicles

100% on new and unused low emission cars ie electrically propelled or with CO_2 emissions of not more than 50 g/km

100% on electric vehicle charging points

Annual investment allowance

£200,000 pa of expenditure incurred by any business on certain plant and machinery from 1 January 2021.

Writing down allowances

18% pa in the main pool

COMPANY VANS, CARS AND FUEL

Van scale charge

No charge applies if there is insignificant private use

£2,792 if van has zero CO_2 emissions and £3,490 if it has CO_2 emissions

Additional £666 if private fuel provided for the van

Company cars – cash equivalent	
Zero emissions cars	0% of list price

Company cars – cash equivalent

	2% of list price for cars with a battery range of >130 miles
	5% of list price for cars with a battery range of 70-129 miles
	8% of list price for cars with a battery range of 40-69 miles
	12% of list price for cars with a battery range of 30-39 miles
Hybrid cars with emissions 1-50g/km	14% of list price for cars with a battery range of <30 miles
Other cars	15% of list price for cars emitting 51-54g/km
	16% of list price for cars emitting 55-59g/km
	17% of list price for cars emitting 60-64g/km
	18% of list price for cars emitting 65-69g/km
	19% of list price for cars emitting 70-74g/km
	20% of list price for cars emitting 75-79g/km
	Increased by 1% per 5g/km over the 75g/km relevant threshold

Relevant % is reduced by 2% for cars first registered from 6 April 2020

Capped at 37% of list price (ie emissions of 160g/km or more for cars first registered before 6 April 2020 and 170g/km for cars first registered from 6 April 2020)

Diesel cars that meet the Real Driving Emissions Step 2 (RDE2) standard are treated as above, all other diesel cars have a 4% supplement added to the relevant percentage (subject to 37% cap)

Private fuel provided for company car

£24,500 x company car %

PAYE CODES	
L	tax code with personal allowance
M	tax code with personal allowance plus claiming marriage allowance
N	tax code with personal allowance less surrendered marriage allowance
S	income taxed at Scottish rate of income tax
C	income taxed at Welsh rate of income tax
K	total allowances are less than total deductions
T	tax code includes other calculations to work the personal allowance, for example it has been reduced because estimated annual income is more than £100,000

NATIONAL INSURANCE CONTRIBUTIONS

	2020/21		
NIC CLASS 1 CONTRIBUTIONS	**Annual**	**Monthly**	**Weekly**
Primary threshold (PT)	£9,500	£792	£183
Secondary threshold (ST)	£8,788	£732	£169
Upper earnings limit (UEL)	£50,000	£4,167	£962

NIC CLASS 1 CONTRIBUTIONS	2020/21	Annual	Monthly	Weekly
Apprentice upper secondary threshold (AUST) for under 25s		£50,000	£4,167	£962
Upper secondary threshold (UST) for under 21s		£50,000	£4,167	£962
Employment allowance (per year, per employer)	£4,000			
Class 1 Primary contributions on earnings between PT & UEL	12%			
Class 1 Primary contributions on earnings above UEL	2%			
Class 1 Secondary contributions on earnings above ST where employee aged 21 or over and not an apprentice under the age of 25	13.8%			
Class 1 Secondary contributions on earnings between ST & AUST for apprentices under the age of 25	0%			
Class 1 Secondary contributions on earnings above AUST for apprentices under the age of 25	13.8%			
Class 1 Secondary contributions on earnings between ST & UST for employees under the age of 21	0%			
Class 1 Secondary contributions on earnings above UST for employees under the age of 21	13.8%			
Class 1A contributions	13.8%			

	2020/21
NIC CLASS 2 CONTRIBUTIONS	
Normal rate	£3.05 pw
Small profits threshold	£6,475 pa
NIC CLASS 4 CONTRIBUTIONS	
Annual lower profits limit (LPL)	£9,500
Annual upper profits limit (UPL)	£50,000
Percentage rate between LPL & UPL	9%
Percentage rate above UPL	2%

Syllabus area: Capital Gains

	2020/21
Annual exempt amount	£12,300
Gains falling within the remaining basic rate band	10%
Gains exceeding the basic rate band	20%
Basic rate band	£1 – £37,500

Syllabus area: Corporation tax

	FY 2020
Tax rate	19%
Augmented profits limit for corporation tax payment dates – large companies	£1,500,000
Augmented profits limit for corporation tax payment dates – very large companies	£20,000,000

CAPITAL ALLOWANCES

First year allowances available

100% on new and unused zero emissions goods vehicles

100% on new and unused low emission cars ie electrically propelled or with CO_2 emissions of not more than 50 g/km

100% on electric vehicle charging points

Annual investment allowance

£200,000 pa of expenditure incurred by any business on certain plant and machinery from 1 January 2021.

Writing down allowances

18% pa in the main pool

PAYMENT DATES

Payment dates for corporation tax	
Corporation tax	Nine months and one day after the end of an accounting period
Corporation tax by instalments – large companies	The 14th day of months 7, 10, 13 and 16 counted from the start of a 12-month accounting period
Corporation tax by instalments – very large companies	The 14th day of months 3, 6, 9 and 12 counted from the start of a 12-month accounting period

Syllabus area: Value Added Tax

VAT		
Standard rate		20%
Reduced rate		5%
Annual registration limit	From 1 April 2017	£85,000
Deregistration limit	From 1 April 2017	£83,000
VAT fraction (standard rated)		1/6

Cash accounting	**£**
Turnover threshold to join scheme	1,350,000
Turnover threshold to leave scheme	1,600,000
Annual accounting	
Turnover threshold to join scheme	1,350,000
Turnover threshold to leave scheme	1,600,000

Flat rate scheme	
Annual taxable turnover limit (excluding VAT) to join scheme	150,000
Annual total income (including VAT) to leave scheme	230,000

Index

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